



Calhoun: The NPS Institutional Archive

Theses and Dissertations

Thesis Collection

2009-12

Who gets a bailout? A comparative analysis of U.S.
and IMF responses to economic crisis in Mexico
(1995), Brazil (1998), and Argentina (2001)

Watkins, Jeremy L.

Monterey, California. Naval Postgraduate School



Calhoun is a project of the Dudley Knox Library at NPS, furthering the precepts and goals of open government and government transparency. All information contained herein has been approved for release by the NPS Public Affairs Officer.

Dudley Knox Library / Naval Postgraduate School
411 Dyer Road / 1 University Circle
Monterey, California USA 93943

<http://www.nps.edu/library>



NAVAL POSTGRADUATE SCHOOL

MONTEREY, CALIFORNIA

THESIS

**WHO GETS A BAILOUT? A COMPARATIVE ANALYSIS
OF U.S. AND IMF RESPONSES TO ECONOMIC CRISIS IN
MEXICO (1995), BRAZIL (1998), AND ARGENTINA (2001)**

by

Jeremy L. Watkins

December 2009

Thesis Advisor:
Second Reader:

Maiah Jaskoski
Mark T. Berger

Approved for public release; distribution is unlimited

THIS PAGE INTENTIONALLY LEFT BLANK

REPORT DOCUMENTATION PAGE			<i>Form Approved OMB No. 0704-0188</i>	
Public reporting burden for this collection of information is estimated to average 1 hour per response, including the time for reviewing instruction, searching existing data sources, gathering and maintaining the data needed, and completing and reviewing the collection of information. Send comments regarding this burden estimate or any other aspect of this collection of information, including suggestions for reducing this burden, to Washington headquarters Services, Directorate for Information Operations and Reports, 1215 Jefferson Davis Highway, Suite 1204, Arlington, VA 22202-4302, and to the Office of Management and Budget, Paperwork Reduction Project (0704-0188) Washington DC 20503.				
1. AGENCY USE ONLY (Leave blank)		2. REPORT DATE December 2009	3. REPORT TYPE AND DATES COVERED Master's Thesis	
4. TITLE AND SUBTITLE Who Gets a Bailout? A Comparative Analysis of U.S. and IMF Responses to Economic Crisis in Mexico (1995), Brazil (1998), and Argentina (2001)			5. FUNDING NUMBERS	
6. AUTHOR(S) LT Jeremy L. Watkins, USN				
7. PERFORMING ORGANIZATION NAME(S) AND ADDRESS(ES) Naval Postgraduate School Monterey, CA 93943-5000			8. PERFORMING ORGANIZATION REPORT NUMBER	
9. SPONSORING /MONITORING AGENCY NAME(S) AND ADDRESS(ES) N/A			10. SPONSORING/MONITORING AGENCY REPORT NUMBER	
11. SUPPLEMENTARY NOTES The views expressed in this thesis are those of the author and do not reflect the official policy or position of the Department of Defense or the U.S. Government.				
12a. DISTRIBUTION / AVAILABILITY STATEMENT Approved for public release; distribution is unlimited			12b. DISTRIBUTION CODE UU	
13. ABSTRACT (maximum 200 words) This thesis seeks to explain why the U.S. government came to the assistance of the Mexican and Brazilian governments in 1995 and 1998, respectively, but refused to do so during Argentina's economic crisis in 2001. At first glance, all three countries appeared attractive candidates for U.S. assistance—they had similarly enacted U.S.-backed neoliberal reformist agendas prior to their crises. The study argues that the decision by the U.S. government and the International Monetary Fund to issue a bailout to a country enduring an economic crisis is a carefully considered policy choice that results from a combination of that country's geopolitical significance, as well as the ability of U.S. policymakers to learn and apply lessons from past policy experiences.				
14. SUBJECT TERMS Economic Crisis, Bailout, Latin America, Mexico, Brazil, Argentina, Geopolitical Significance			15. NUMBER OF PAGES 73	
			16. PRICE CODE	
17. SECURITY CLASSIFICATION OF REPORT Unclassified	18. SECURITY CLASSIFICATION OF THIS PAGE Unclassified	19. SECURITY CLASSIFICATION OF ABSTRACT Unclassified	20. LIMITATION OF ABSTRACT UU	

NSN 7540-01-280-5500

Standard Form 298 (Rev. 2-89)
Prescribed by ANSI Std. Z39-18

THIS PAGE INTENTIONALLY LEFT BLANK

Approved for public release; distribution is unlimited

**WHO GETS A BAILOUT? A COMPARATIVE ANALYSIS OF U.S. AND IMF
RESPONSES TO ECONOMIC CRISIS IN MEXICO (1995), BRAZIL (1998), AND
ARGENTINA (2001)**

Jeremy L. Watkins
Lieutenant, United States Navy
B.S., United States Naval Academy, 2003

Submitted in partial fulfillment of the
requirements for the degree of

**MASTER OF ARTS IN SECURITY STUDIES
(WESTERN HEMISPHERE)**

from the

**NAVAL POSTGRADUATE SCHOOL
December 2009**

Author: Jeremy L. Watkins

Approved by: Maiah Jaskoski, PhD
Thesis Advisor

Mark T. Berger, PhD
Second Reader

Harold A. Trinkunas, PhD
Chairman, Department of National Security Affairs

THIS PAGE INTENTIONALLY LEFT BLANK

ABSTRACT

This thesis seeks to explain why the U.S. government came to the assistance of the Mexican and Brazilian governments in 1995 and 1998, respectively, but refused to do so during Argentina's economic crisis in 2001. At first glance, all three countries appeared attractive candidates for U.S. assistance—they had similarly enacted U.S.-backed neoliberal reformist agendas prior to their crises. The study argues that the decision by the U.S. government and the International Monetary Fund to issue a bailout to a country enduring an economic crisis is a carefully considered policy choice that results from a combination of that country's geopolitical significance, as well as the ability of U.S. policymakers to learn and apply lessons from past policy experiences.

THIS PAGE INTENTIONALLY LEFT BLANK

TABLE OF CONTENTS

I.	INTRODUCTION.....	1
A.	IMPORTANCE.....	1
B.	BACKGROUND.....	2
C.	LITERATURE REVIEW.....	5
D.	METHODOLOGY.....	8
II.	CASES.....	11
A.	MEXICO 1995.....	11
1.	Background Conditions and Economic Crisis.....	11
2.	U.S. and IMF Response.....	14
3.	Outcome of the Policy Choice.....	15
B.	BRAZIL 1998.....	16
1.	Background Conditions and Economic Crisis.....	16
2.	U.S. and IMF Response.....	18
3.	Outcome of the Policy Choice.....	19
C.	ARGENTINA 2001.....	19
1.	Background Conditions and Economic Crisis.....	20
2.	U.S. and IMF Response.....	23
3.	Outcome of the Policy Choice.....	25
III.	ANALYSIS.....	27
A.	HYPOTHESIS 1: GEOPOLITICAL SIGNIFICANCE OF THE COUNTRY.....	27
1.	Mexico.....	27
2.	Brazil.....	31
3.	Argentina.....	34
4.	Hypothesis Validity.....	36
B.	HYPOTHESIS 2: U.S. EXECUTIVE IDEOLOGY.....	37
1.	Mexico.....	37
2.	Brazil.....	39
3.	Argentina.....	40
4.	Hypothesis Validity.....	41
C.	HYPOTHESIS 3: U.S. EXECUTIVE LEARNING FROM PAST POLICY CHOICES.....	43
1.	Mexico.....	43
2.	Brazil.....	45
3.	Argentina.....	49
4.	Hypothesis Validity.....	51
IV.	CONCLUSION.....	53
	BIBLIOGRAPHY.....	57
	INITIAL DISTRIBUTION LIST.....	61

THIS PAGE INTENTIONALLY LEFT BLANK

ACKNOWLEDGMENTS

I would like to thank Dr. Maiah Jaskoski for her time and for the sage guidance she provided me throughout this process. Additionally, and most importantly, I could not have finished this paper without the support and understanding of my wife, Melissa, and our dog, Blackjack.

THIS PAGE INTENTIONALLY LEFT BLANK

I. INTRODUCTION

The three Latin American countries with the largest economies according to gross domestic product (GDP)—Brazil, Mexico, and Argentina, respectively—have all suffered recent economic crises. Governments in all three countries had previously implemented many of the neoliberal reforms mandated by the Washington Consensus and the International Monetary Fund (IMF). In the 1990s, states that enacted reformist agendas were classified by Javier Corrales as shallow, intermediate, or aggressive based on the “evaluation of accomplishments in various reform categories dear to free-marketeters: inflation reduction, trade opening, financial liberalization, fiscal deficit reduction, privatization of money-losing state owned enterprises, and deregulation of markets.”¹ Both Mexico and Argentina were classified as aggressive reformers while Brazil was labeled an intermediate reformer.

During its economic crisis in 1994–1995, Mexico received a bailout, or large and immediate loan package, from the United States and the IMF. Similarly, when struck by its own crisis in 1998, Brazil received an even larger bailout with a majority of the funding coming from the United States and the IMF. However, when, in December 2001, an economic crisis hit Argentina, the Latin American country that was often said to have most stringently implemented liberal market policies, a bailout from the U.S. and the IMF was denied. If all three of these states followed many orthodox economic prescriptions, then why did Mexico and Brazil receive bailouts from the United States and the IMF while Argentina did not?

A. IMPORTANCE

Given the large amounts of money associated with bailouts given to individual nations by the United States and the IMF, it is critical that we better understand the conditions under which these massive loans are granted. Indeed, in the cases studied here, the sizes of the bailout packages have been significant: Mexico received

¹ Javier Corrales, “Market Reforms,” in *Constructing Democratic Governance in Latin America*, 74–99 (Baltimore: The Johns Hopkins University Press, 2003), 90.

\$52.8 billion and Brazil received \$41.5 billion. By seeking to add to our understanding of why bailouts are granted (and also denied), this thesis not only helps us to understand the processes by which the U.S. government invests its money internationally, but it also holds direct normative implications for U.S. policymaking. Are the U.S. spending processes arrived at through appropriate processes of deliberation in Congress, or do they largely consist of personalistic, presidential projects that sometimes confuse their own private interests or ideology with the public good? In my view, the will of the people via their representatives in Congress provides a better and more deliberate appropriations process than can be offered by the simple whims of a singular executive. The legislative election cycle in the U.S. generally makes Congress more accountable to the public by providing an outlet for turnover every two years.

At the descriptive level, the thesis will present a detailed description of a failed bailout in which the U.S. government wasted its money—the case of Brazil—in addition to the successful case of Mexico. The thesis leaves it to future research to explain the reasons why some bailouts successfully resolve crises, whereas others do not.

B. BACKGROUND

This thesis will seek to explain why the U.S. government came to the assistance of the Mexican and Brazilian governments in 1995 and 1998, respectively, but refused to do so during Argentina's economic crisis in 2001. It argues that the decision by the U.S. government and the IMF to issue a bailout to a country enduring an economic crisis is a carefully considered policy choice that results from a combination of that nation's geopolitical significance as well as the ability of those policymakers to learn lessons from past policies.

Prior to Mexico's financial crisis in December 1994, both the U.S. government and Wall Street advertised Mexico's free market economic policies as the model for other developing nations to follow.² U.S. government and investor confidence in Mexico's economy was at an all-time high as the North American Free Trade Agreement (NAFTA)

² Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 73.

began on January 1, 1994. The Salinas government wanted to prove the durability and growth potential of Mexico's increasingly globalized market, and NAFTA "codified the new rules of the game and greatly reduced the uncertainty faced by investors."³ The new codes restrained the potential for sudden protectionist measures by both the Mexican and U.S. governments. In order to offer foreign investors a sense of stability, Mexico's government committed to a fixed exchange rate for its currency, whereby the peso was pegged to the U.S. dollar at a ratio of about 3:1.⁴

1994 was also a year of political turmoil in Mexico. Specific examples of the domestic political turmoil included the shocking, major revolt by the EZLN, or "Zapatistas," an insurgency (which later departed from its violent tactics), as well as political upheaval and scandal in the wake of the assassinations of two major political figures, Luis Donaldo Colosio—the PRI's original presidential candidate—and Jose Francisco Ruiz Massieu, who was slated to become the leader of the PRI in the Chamber of Deputies of the Mexican Congress.⁵ It was also a presidential election year. These factors increased Mexico's "country risk" and startled international investors and the Mexican public, who began to sell their Mexican holdings. This outflow triggered a rapid increase in the conversion of pesos to dollars as a result of rising devaluation fears.⁶ The Mexican Central Bank was unable to maintain the fixed exchange rate and fueled the selloff until the peso fully devalued.

The Mexican government could not contain the collapse of their currency and turned to international support. The resulting loan package put together by the U.S.

³ Aaron Tornell, Frank Westermann and Lorenza Martínez, "Liberalization, Growth, and Financial Crises: Lessons from Mexico and the Developing World," *Brookings Papers on Economic Activity* (The Brookings Institution) 2003, no. 2 (2003): 1–88, 40.

⁴ Crandall, *United States and Latin America*, 74.

⁵ Gary L. Springer and Jorge L. Molina, "The Mexican Financial Crisis: Genesis, Impact, and Implications," *Journal of Interamerican Studies and World Affairs* 37, no. 2 (Summer 1995): 57–81., 62.

⁶ Devaluation reduces the profits of investors reliant on dollar denominated profit. Crandall offers a simple example of how devaluation affects investment. "Consider, an American firm that holds 300 pesos in profit at a time when the exchange rate is 3 pesos to U.S.\$1 (3:1). Thus, after going to the Mexican Central Bank to convert 3000 pesos at the 3:1 rate, the American firm's profit is \$100. If there is a devaluation that suddenly bumps the exchange rate to 6 pesos to U.S.\$1, then the profit of 300 pesos becomes only U.S.\$50," 74.

government, the IMF, and other international entities totaled \$52.8 billion.⁷ The intent of this package was to stabilize the peso. This bailout worked: Mexico's economy rapidly shrugged the crisis and posted hearty economic growth with low associated inflation, and repaid the loan with interest in just two years.⁸

Brazil's currency, the real, was also linked to the dollar as a part of its broad economic strategy to maintain market stability and investor confidence. In the wake of the Asian financial crisis, many economists predicted that Brazil would be the next country to fall. In addition to the austerity measures put in place by Brazilian President Fernando Henrique Cardoso, the U.S. government and the IMF put together a bailout package totaling \$41.5 billion. This bailout was intended to preempt a massive selloff of the real by increasing Brazil's foreign reserves and avoid devaluation in order to maintain their currency's peg to the dollar. This bailout did not prevent the devaluation of the real nor did it stave off economic crisis. In other words, the bailout failed.⁹

Much like Mexico, Argentina was often touted as the "poster child¹⁰" for countries looking to liberalize their economies. It, too, tied its peso to the U.S. dollar via a fixed exchange rate of 1:1. More so than either Mexico or Brazil, Argentina fervently clung to its fixed exchange rate (which would require the Argentine Congress's approval to change it) and paradoxically suffered when Brazil ultimately devalued its currency as its domestic goods became too expensive. Prior to 2001, Argentina had received its regularly scheduled loans from the IMF. In the summer of 2001 a rapid selloff of pesos in exchange for dollars began and severely threatened the Argentine economy by depleting its foreign reserves. Based on the precedents set by the U.S. government and IMF response to economic crises in Mexico and Brazil just a few years earlier, President de la Rúa expected their affirmative response to his request for augmentation to his

⁷ Crandall, 76.

⁸ Crandall, 76.

⁹ Crandall, 78.

¹⁰ Manuel Pastor and Carol Wise, "Argentina: From Poster Child to Basket Case," *Foreign Affairs* 80, no. 6 (2001): 60–72.

previously scheduled loans. Neither the Bush administration nor the IMF agreed to the increase. Additionally, the IMF cancelled the terms previously scheduled loan, leaving Argentina to fend for itself.

Is the policy of issuing a bailout to a nation facing economic crisis a carefully considered policy tool that is used deliberately to advance U.S. economic or political interests? The answer to this question is important in order to determine whether or not vast sums of tax dollars are appropriately allocated. In all three cases the nations similarly followed (to some degree) the liberal economic prescriptions mandated by the IMF as conditions to international lending. In the cases of Mexico and Brazil, significant bailouts were offered. Yet in Argentina a bailout was refused. Why? This thesis will seek to test three hypotheses for U.S. bailouts in Latin America. It will argue that the more geopolitically significant the nation in the midst of economic crisis, the more likely it will receive a bailout. Additionally, policymakers tend to apply lessons learned from past policy choices in their decision to issue a new bailout.

C. LITERATURE REVIEW

In this review of the literature I will discuss three potential hypotheses to explain the variation in the distribution of U.S. government and IMF bailouts with respect to Mexico and Brazil on the one hand and Argentina on the other.

The first hypothesis for determining the likelihood of a country receiving a bailout resides in its geopolitical and economic significance to the United States. This hypothesis states that only geopolitically significant nations will receive a bailout and largely focuses on the scope of economic interdependence shared between the United States and the country looking for a bailout. Because of the degree to which a nation's economy is sufficiently intertwined with that of the United States, policymakers may deem that country too big to fail. The potential detrimental effects an economic crisis in one country could have on the U.S. economy may incline policymakers to utilize a bailout as a policy option. The U.S. government may consider the use of bailouts as a tool if they are politically viable policy measures that promise reward relative their risk. Increasing interdependence via free trade will likely improve the calculus that determines

whether or not a bailout will be issued. Because of the heavy influence of the U.S. Treasury on IMF decisions, U.S. trade interests also translate into IMF decisions about whether or not to bail out a country's government during crisis.¹¹

The second hypothesis states that the difference in the political ideology of the U.S. ruling party or president will determine the likelihood of bailouts being issued in the event of an economic crisis. Russell C. Crandall's work, *The United States and Latin America After the Cold War*, argues that domestic politics and personal ideologies of key policymakers in Washington have shaped the way the U.S. conducts foreign policy in the post Cold War era.¹² Oftentimes, these policies are quickly implemented without regard for history's lessons on American involvement in the Western Hemisphere. By emphasizing the need to understand historical case studies as a guide to implementing contemporary policy, Crandall's argument offers a pragmatic way to examine why U.S. policy toward Latin America is created without disrespecting history's facts. This second hypothesis claims that when Democrats hold the presidency in the United States, the U.S. government bails out countries in crisis because of ideological stances. Changes in ideology, either domestically or globally, cannot be ruled out as an explanatory variable in deciding cases of global financing.¹³ Democrats can bailout a nation even when Republicans control Congress, due to the Exchange Stabilization Fund (ESF). The ESF, created to ensure the dollar's stability, makes funds available to the executive without the requirement of oversight from the legislature.

¹¹ U.S. dominance of the Fund's 24-member board can be gauged by the weight its vote receives relative to other member nations. Weight for the vote comes from the member nation's contribution to the Fund. The U.S. vote is 18% of the IMF, which is three times more than any other nation. Only eight board members represent individual nations, the rest represent blocs of nations. Of the eight individually represented nations, the G-7 (U.S., Japan, Germany, Britain, Italy, and Canada) often deliberates to come to a consensus prior to voting in order to guarantee their consolidated position is adopted. This information is available from multiple sources including Thacker, Blustein, and Crandall.

¹² Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 12.

¹³ Dennis P. Quinn and A. Maria Toyoda, "Ideology and Voter Preferences as Determinants of Financial Globalization," *American Journal of Political Science* (Midwest Political Science Association) 51, no. 2 (April 2007): 344–363, 344.

The literature relating to the idea that policymakers learn from past policy decisions is vast. Peter J. May provides an excellent review of this literature and posits the following:

Learning implies improved understanding, as reflected by an ability to draw lessons about policy problems, objectives, or interventions. The lessons are not necessarily refined understandings of policy cause and effect that might emerge from formal evaluations or policy experiments. Rather, as with trial-and-error learning, learning can simply entail judgments about whether a given course of action or a given policy tool is still preferred relative to the alternatives currently being promoted.¹⁴

As a third hypothesis, and perhaps as a corollary to the both previous hypotheses, I will discuss whether or not across-time learning, despite ideological convictions, by the U.S. government occurred with respect to the successful bailout of Mexico in 1995 and the failed bailout of Brazil in 1998. Learning lessons from the risky strategy of over-borrowing massive amounts of foreign dollars combined with the adherence to the fixed exchange rate may be crucial in understanding the dynamics of the crises as well as the associated response from foreign lenders.¹⁵ The steadfast commitment to a fixed exchange rate can, and did in these cases, lead to an overvalued rate of exchange, loan defaults, and serious economic crises.¹⁶ This policy may have caused the crisis to become more sudden and severe. A country that stringently adhered to this policy, as in Argentina's case, may be denied a bailout if this lesson was in fact learned by policymakers.

This hypothesis suggests that policymakers utilized lessons learned from the implementation, timing, and outcomes of the previous bailouts to Mexico and Brazil in determining whether or not Argentina would receive a bailout. Mexico was given a bailout following the devaluation of its currency while Brazil was given a bailout in order

¹⁴ Peter J. May, "Policy Learning and Failure," *Journal of Public Policy* (Cambridge University Press) 12, no. 4 (October-December 1992): 331–354, 333.

¹⁵ Martin Feldstein, "Argentina's Fall: Lessons from the Latest Financial Crisis," *Foreign Affairs* (Council on Foreign Relations) 81, no. 2 (March-April 2002): 8–14, 14.

¹⁶ Geethanjali Nataraj and Pravakar Sahoo, "Argentina's Crisis: Causes and Consequences," *Economic and Political Weekly* (Economic and Political Weekly) 38, no. 17 (April 26– May 2, 2003): 1641–1644, 1644.

to preempt the devaluation of the real. Because of the successful and quick repayment of the Mexican bailout, political support for the policy in general increased and policymakers were more inclined to utilize it as a foreign policy tool to maintain economic stability. The success of the Mexican bailout when compared to the failure of the Brazilian bailout could demonstrate the importance of timing with respect to how and when to implement this policy effectively and shows that, “Authorities should focus on what to do after the crisis instead of attempting to forestall the crisis.”¹⁷

Failure to obtain the necessary granularity on the details surrounding the depth of Brazilian crisis in 1998 resulted in the Clinton administration and the IMF formulating a response that looked nearly identical to the Mexican bailout three years earlier.¹⁸ Different lessons can be taken from the analysis of each policy decision and will not necessarily determine successful policy implementation in the future. The comparative results of both cases may have helped determine Argentina’s fate more so than simply the ideology of an American President. The failure of the Brazilian bailout could have reduced necessary support for the U.S. and the IMF policymakers to bailout Argentina in 2001. The Argentine government’s commitment to the convertibility law that pegged the peso to the dollar eliminated devaluation as an option to stave off the crisis. By not devaluing their currency, the situation in Argentina would have looked strikingly similar to the economic crisis in Brazil and the bailout’s failed attempt to prevent the real from devaluing in 1998. If the Bush administration recognized this intricacy, and had Argentina devalued its currency and entered into a full-blown crisis, it would have been more likely to receive a bailout package similar to the one given to Mexico.

D. METHODOLOGY

The methodology to be used in this thesis will compare the three cases—Mexico in 1995, Brazil in 1998, and Argentina in 2001—to determine the causal mechanism that leads to the utilization of a bailout as policy measure by the U.S. government and the

¹⁷ Tornell, Westermann and Martínez, 68.

¹⁸ Crandall, 77.

IMF to forestall an economic crisis. The variation among the three cases will be examined through three generalized hypotheses.

- *Hypothesis 1: Geopolitical Significance*, states that a country that is more geopolitically significant to the interests of the United States will be more likely to receive a bailout in the event of an economic crisis. This hypothesis will be identified by the short title Geopolitical Significance.
- *Hypothesis 2: Ideologically Driven*, states that the political ideology of the U.S. President is the major factor that determines whether or not a bailout will be given to a nation in the midst of an economic crisis. This hypothesis will be identified by the short title Ideology.
- *Hypothesis 3: Learning From Past Policy*, states that political leaders in the United States learn from the results of past policy decisions and are therefore better equipped to determine when and if a nation should receive a bailout. This hypothesis will be identified by the short title Learning.

This form of methodology will attempt to uncover the distinct characteristics of economic crises and associated policy response to better determine the likelihood of a bailout being approved for an individual nation experiencing an economic crisis.

THIS PAGE INTENTIONALLY LEFT BLANK

II. CASES

A. MEXICO 1995

This examination of Mexico's peso crisis to determine the factors that caused the U.S. and the IMF to offer Mexico a prompt and massive bailout will first provide a narrative of the conditions leading up to the economic crisis. I will then detail the associated U.S. and IMF policy response to the crisis and the outcome of their policy choice.

1. Background Conditions and Economic Crisis

Prior to Mexico's financial crisis in December of 1994, both the U.S. government and Wall Street advertised Mexico's free market economic policies as the model for other developing nations to follow.¹⁹ U.S. government and investor confidence in Mexico's economy was at an all-time high as the North American Free Trade Agreement (NAFTA) began on January 1, 1994. The Salinas government wanted to prove the durability and growth potential of Mexico's increasingly globalized market, and NAFTA "codified the new rules of the game and greatly reduced the uncertainty faced by investors."²⁰ The new codes restrained the potential for the implementation of sudden protectionist measures by both Mexico and the United States. In addition to the signing of NAFTA, Mexico's commitment to liberalizing most of its markets during President Salinas' six-year term is indicated by its: active participation in the Uruguay Round of the General Agreement on Tariffs and Trade (GATT), and its full membership in such developed-country associations as the Organization for Economic Cooperation and Development (OECD) and the forum for Asian-Pacific Economic Cooperation (APEC).

¹⁹ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 73.

²⁰ Aaron Tornell, Frank Westermann and Lorenza Martínez, "Liberalization, Growth, and Financial Crises: Lessons from Mexico and the Developing World," *Brookings Papers on Economic Activity* (The Brookings Institution) 2003, no. 2 (2003): 1–88, 40.

As a result of its sudden “willingness to ‘join the world,’ Mexico had become one of the world’s most attractive destinations for investment, both direct and portfolio.”²¹ In order to offer foreign investors a sense of stability, and a form of protection against inflation, Mexico’s government committed to a fixed exchange rate for its currency, whereby the peso was pegged to the U.S. dollar at a ratio of about 3:1.²² Additionally, from 1990–1994 the Mexican operational budget balance maintained a surplus.²³ Mexico exhibited sound fiscal discipline throughout this time period, and the peso crisis in Mexico should not be attributed to irresponsible fiscal behavior.²⁴

In this context, a combination of destabilizing attacks on domestic political institutions and strict adherence to a policy of fixed exchange rates triggered the peso crisis in Mexico. The destabilizing attacks on domestic political institutions, which included terrorism, corruption, and political assassinations, effectively strained the Mexican government’s ability to maintain investor confidence. These factors contributed the growing view of Mexico’s ability to provide the stability necessary to attract and sustain economic growth through foreign and domestic investment. The Mexican government’s full commitment to the fixed exchange rate policy would artificially overvalue the peso in light of these events.

A year of political turmoil shook Mexico in 1994. Specific, and the most significant, examples of the domestic political turmoil included the shocking, major revolt by the insurgent Zapatista Army of National Liberation (EZLN), or “Zapatistas,” as well as political upheaval and scandal in the wake of the assassinations of two major political figures. The EZLN unexpectedly declared war on the Salinas government on the very same day that NAFTA was put into effect, January 1, 1994. This massive revolt in

²¹ Gary L. Springer and Jorge L. Molina, “The Mexican Financial Crisis: Genesis, Impact, and Implications,” *Journal of Interamerican Studies and World Affairs* 37, no. 2 (Summer 1995): 57–81, 69.

²² Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 74.

²³ Jeffrey Sachs, Aaron Tornell, Andres Velasco, Francesco Giavazzi and Istvan Szekely, “The Collapse of the Mexican Peso: What Have We Learned?,” *Economic Policy*, Vol. 11, No. 22 (Apr., 1996), 13–63 (Blackwell Publishing) 11, no. 22 (April 1996): 13–63, 16.

²⁴ Jeffrey Sachs, Aaron Tornell, Andres Velasco, Francesco Giavazzi and Istvan Szekely, “The Collapse of the Mexican Peso: What Have We Learned?,” *Economic Policy*, Vol. 11, No. 22 (Apr., 1996), 13–63 (Blackwell Publishing) 11, no. 22 (April 1996): 13–63, 16.

Mexico's southern state of Chiapas had an initial violent, yet short-lived, uprising to bring attention to the voice of Mexico's poor in the face of globalization. The challenge to Mexico's political stability from the Zapatistas "called into question Mexico's new status as a 'more-developed' nation."²⁵ This insurgency, rightly or wrongly, dramatically damaged investor confidence in the Mexican government's ability to provide security for their ventures.

Further shocks to Mexico's political system, during the presidential election year of 1994, came from the high-level assassinations of Luis Donaldo Colosio, the PRI's original presidential candidate, and Jose Francisco Ruiz Massieu, who was slated to become the leader of the PRI in the Chamber of Deputies of the Mexican Congress.²⁶ These politically motivated murders strengthened the argument against Mexico's capacity to maintain stability and protect investment by weakening investor perceptions about the strength of Mexico's political institutions.

These two political shocks in particular led to a dramatic downturn in foreign lending to Mexico. This decrease in lending was not addressed with appropriate economic policy changes by the Salinas administration to stabilize the pressures placed on the market.²⁷ These factors increased Mexico's "country risk" and startled international investors and the Mexican public who began to sell their Mexican holdings.

This initial outflow, resulting from political shocks and waning investor confidence, triggered a growing increase in the conversion of pesos to dollars at the fixed rate of exchange. As the nation's dollar reserves began to shrink ever more rapidly, investors feared devaluation and incited a "herd mentality" sellout, whereby investors sold their holdings simply based on the fact that other people were selling theirs.²⁸ The

²⁵ Gary L. Springer and Jorge L. Molina, "The Mexican Financial Crisis: Genesis, Impact, and Implications," *Journal of Interamerican Studies and World Affairs* 37, no. 2 (Summer 1995): 57–81, 60.

²⁶ Gary L. Springer and Jorge L. Molina, "The Mexican Financial Crisis: Genesis, Impact, and Implications," *Journal of Interamerican Studies and World Affairs* 37, no. 2 (Summer 1995): 57–81., 62.

²⁷ Jeffrey Sachs, Aaron Tornell, Andres Velasco, Francesco Giavazzi and Istvan Szekely, "The Collapse of the Mexican Peso: What Have We Learned?," *Economic Policy*, Vol. 11, No. 22 (Apr., 1996), 13–63 (Blackwell Publishing) 11, no. 22 (April 1996): 13–63, 33.

²⁸ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 74.

government did not recognize that this selloff was permanent and believed that demand for Mexican assets would return without removing the peg.²⁹ Because of the Salinas administration's miscalculation and unwillingness to float the exchange rate, and thereby appreciate the dollar at the peso's expense, the selloff continued. Empirically speaking, in 1994 Mexico's foreign-exchange reserves were depleted from a high of \$30 billion to only \$6 billion dollars. In December alone, approximately \$4–\$6 billion left the nation's coffers.³⁰

Finally, on December 20, 1994, and just three weeks into the Zedillo administration, the new administration moved swiftly to expand the band in which the peso could float by 15.3%. This move served as the final test of investor fears that the currency would be devalued and prompted a final run on the peso. The following day, the Finance Ministry removed the peso's peg to the dollar and announced it would float freely against the dollar. The peso then promptly lost one half of its value, and the Mexican economy officially fell into crisis.³¹

2. U.S. and IMF Response

The Mexican government turned to international support in order to contain the crisis. The Clinton administration feared that the economic crisis in Mexico would spread across the border and harm the U.S. economy.³² To prevent such a spread from occurring, President Clinton determined that Mexico needed to be bailed out—and fast. Support for Clinton's plan in the Republican-led U.S. Congress dwindled fast, and it ultimately rejected Clinton's planned use of congressionally appropriated funds to support this massive loan. In an unprecedented move, determined to get the bailout to Mexico, Clinton sidestepped the legislative process and utilized the U.S. Exchange

²⁹ Bradford De Long, Christopher De Long and Sherman Robinson, "The Case for Mexico's Rescue: The Peso Package Looks Even Better Now," *Foreign Affairs* (Council on Foreign Relations) 75, no. 3 (May–June 1996): 8–14, 11.

³⁰ Timothy P. Kessler, "Political Capital: Mexican Financial Policy under Salinas," *World Politics* (The Johns Hopkins University Press) 51, no. 1 (October 1998): 36–66, 58.

³¹ Timothy P. Kessler, "Political Capital: Mexican Financial Policy under Salinas," *World Politics* (The Johns Hopkins University Press) 51, no. 1 (October 1998): 36–66, 59.

³² Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 75.

Stabilization Fund (ESF) to provide the loan. The ESF, created to ensure the dollar's stability, makes funds available to the executive without the requirement of oversight from the legislature.

Furthermore, to prevent Congress from blocking the loan, Clinton attached conditions to the bailout that made it unwilling to move against the bailout.³³ These conditions “(1) required Mexico to pay interest and fees on medium-term swaps; (2) made disbursement of funds contingent on ‘certification’ of Mexico's adherence to strict IMF monetary targets; and (3) took the revenues from Mexican oil exports as collateral.”³⁴ These conditions provided Clinton a degree of control over Mexico's economic policy and assured him near certain return on the loan by holding Mexico's oil as collateral. The conditionality requirements attached to the bailout shaped the policies that would be enacted to restructure the Mexican economy, while at the same time pressured Mexico to repay the loan in order to retain a national hold on the oil reserves. It also protected Clinton from moves by his political rivals to stand against his rescue package.

The resulting loan package put together by the U.S. government, the IMF, and other international entities totaled \$52.8 billion.³⁵ The intent of this package was to stabilize the peso and bring investors back to Mexico.

3. Outcome of the Policy Choice

The Clinton bailout worked: Mexico's economy rapidly shrugged the crisis and posted hearty economic growth with low associated inflation, and repaid the loan with interest in just two years.³⁶ “Mexico registered a \$7.4 billion trade surplus in 1995. Real exports were more than 30% higher in 1995 than in 1994, while imports fell more than 8

³³ Bradford De Long, Christopher De Long and Sherman Robinson, “The Case for Mexico's Rescue: The Peso Package Looks Even Better Now,” *Foreign Affairs* (Council on Foreign Relations) 75, no. 3 (May–June 1996): 8–14, 14.

³⁴ Gary L. Springer and Jorge L. Molina, “The Mexican Financial Crisis: Genesis, Impact, and Implications,” *Journal of Interamerican Studies and World Affairs* 37, no. 2 (Summer 1995): 57–81, 66.

³⁵ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 76.

³⁶ Crandall, 76.

percent.”³⁷ These numbers demonstrate the fact that Mexico would be able to repay its debts immediately. This was a positive sum game where benefits were provided to all involved parties: Mexico, the U.S., the IMF, and other international investors. Mexico saw continued economic growth and those who funded the rescue package were repaid promptly. Additionally, the spread of a deeper crisis throughout the region was dampened, and a true depression was forestalled.

B. BRAZIL 1998

In order to determine the factors that caused the U.S. and the IMF to offer Brazil a prompt and massive bailout, this examination will first provide a narrative of the conditions leading up to the crisis. I will then detail the associated U.S. and IMF policy response to the crisis and the outcome of their policy choice.

1. Background Conditions and Economic Crisis

Traditionally, Brazil’s massive economy has been hamstrung by persistently high inflation. Inflation exceeded 50% per year each year from 1979 to 1994, when it rose to over 5,000%.³⁸ In 1994, then Minister of Finance, Fernando Henrique Cardoso introduced *Plano Real*, a sweeping policy aimed at reducing inflation. As is indicated by the 2.5% rate of inflation posted in 1998, this program was wildly successful, especially given Brazil’s chronic struggle against inflation and failed past attempts at stabilization.³⁹ A key mechanism used by *Plano Real* to get inflation under control was to strongly link its currency to the dollar via a crawling peg. Implementation of the crawling peg meant that the Brazilian Central Bank would attempt to manage the exchange rate within a small band in order to maintain parity with the dollar regardless of market pressures.

³⁷ Bradford De Long, Christopher De Long and Sherman Robinson, “The Case for Mexico’s Rescue: The Peso Package Looks Even Better Now,” *Foreign Affairs* (Council on Foreign Relations) 75, no. 3 (May–June 1996): 8–14, 12.

³⁸ Jeffrey Sachs and Zini Jr Alvaro A., “Brazilian inflation and the Plano Real,” *World Economy* (Blackwell Publishers Ltd) 19, no. 1 (January 1996): 13–37, 13–14.

³⁹ Victor Bulmer-Thomas, “The Brazilian Devaluation: National Responses and International Consequences,” *International Affairs (Royal Institute of International Affairs 1944)* (Blackwell Publishing on behalf of the Royal Institute of International Affairs) 75, no. 4 (October 1999): 729–741, 729.

Cardoso was able to parlay this economic success into electoral victory during the presidential elections in both 1994 and 1998. As president, Cardoso failed to maintain the necessary fiscal discipline that would complement the success of *Plano Real* in fighting inflation. Under Cardoso, deficit spending increased to 8.4% of GDP in 1998.⁴⁰ It is generally accepted by economists at the IMF that market stabilization is unlikely in an emerging market that cannot maintain fiscal discipline. For comparison, fiscal adjustment recommendations by the IMF usually call for a nation to produce a budget surplus, while deficit spending in countries in the Euro zone is limited to 3% of GDP.

In 1998 this macroeconomic strategy began to unravel in the face of a troubled international financial system. Economic crisis struck Russia and many Asian countries, many of which devalued their currencies following exchange rate problems similar to those faced by Mexico during the peso crisis in 1994.⁴¹ Many analysts and speculators saw Brazil as the next country likely to fall victim to this crisis and quickly began to sell their holdings in Brazil. To stop the continued selloff and presumably to increase demand for the *real*, the Central Bank raised the interest rates multiple times on their long-term bonds. In fact, interest rates were hiked to over 40% per year in 1998.⁴² In the context of a sizeable fiscal deficit and the deteriorating global economic situation, this strategy failed to create a real sense of stability for its investors, who continue to dump their assets. At a high of \$74 billion in August of 1998, Brazil's reserves had fallen to \$42 billion by the time Cardoso returned to office following his reelection later that year.⁴³

⁴⁰ Victor Bulmer-Thomas, "The Brazilian Devaluation: National Responses and International Consequences," *International Affairs (Royal Institute of International Affairs 1944)* (Blackwell Publishing on behalf of the Royal Institute of International Affairs) 75, no. 4 (October 1999): 729–741, 730.

⁴¹ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 77.

⁴² Louis Uchitelle, "Calculated Risk: U.S. and I.M.F. Lead Push for Brazil Bailout Plan," *New York Times*, September 28, 1998, Late Edition (East Coast) ed.: A.1.

⁴³ Peter Flynn, "Brazil: The Politics of Crisis," *Third World Quarterly* (Taylor & Francis, Ltd.) 20, no. 2 (April 1999): 287–317, 288.

2. U.S. and IMF Response

The Clinton administration watched this situation in Brazil and feared that an economic crisis, were it to hit, could have catastrophic consequences for the rest of the region due to its large economy. Prior to the devaluation of the Brazilian real, the Brazilian economy was the ninth largest in the world, after the G-7 and China, and represented over 35% of the Latin American economy when examined by GDP.⁴⁴ The magnitude of this economy indicates its capacity to influence and affect the markets of throughout the region.

With a feather in their cap from successfully reversing Mexico's crisis in 1994, the Clinton White House and the IMF that decided action to prevent a crisis in Brazil would be necessary.⁴⁵ In order to prevent a crisis a massive bailout package would be put together. This time the Clinton administration would try to prevent the devaluation of the *real* by filling the Brazilian Central Bank's dwindling reserves with dollars. In theory this massive influx of dollars would stabilize the Brazilian economy by stopping the run on currency. Investors, however, would prove not to see this policy in the same light as the U.S. and IMF architects of the rescue package.

The U.S.-designed bailout totaled \$41.5 billion, which came from the IMF, the U.S. Treasury, and other international investors. The Clinton administration again utilized executive discretion via the ESF to provide the U.S. portion of the loan and eliminate any congressional debate about the appropriation of tax dollars. This package was delivered to Brazil without much discussion or debate from Clinton's political opposition.

This package was substantially different from the bailout given to Mexico in two very significant ways. First, Mexico was given a bailout following the devaluation of its currency and significant loss of its dollar reserves, whereas, the Brazilian bailout was issued prior to the *real's* devaluation. Secondly, Mexico's bailout was protected by

⁴⁴ Victor Bulmer-Thomas, "The Brazilian Devaluation: National Responses and International Consequences," *International Affairs (Royal Institute of International Affairs 1944-)* (Blackwell Publishing on behalf of the Royal Institute of International Affairs) 75, no. 4 (October 1999): 729–741, 729.

⁴⁵ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 77.

tangible collateral in the form of revenue from its massive oil reserves and stringent fiscal conditionality, while the loan to Brazil did not utilize collateral to protect itself in the event of a default. This loan, however, was not disbursed to Brazil without Cardoso's commitment to near-term fiscal reform. Prior to the approval of the bailout, President Cardoso, with enthusiastic IMF support, announced a bold austerity program that cut spending and raised taxes.⁴⁶

3. Outcome of the Policy Choice

This bailout quickly and ultimately proved to be a failure. Devaluation of the *real* was not preempted by the rescue package. The \$41.5 billion bailout designed to defend the *real* was trumped by the Brazilian Central Bank's decision to abandon the policy of pegging its currency to the dollar and ultimately devalue the real in January of 1999. "On January 15, with capital flight eroding Brazil's reserves, the real was allowed to float freely. The unintended result was a panic-driven massive depreciation of the real's exchange value by 60% in a few days."⁴⁷ Panic of this sort can be largely attributed to the fact that international investors did not view the newly filled reserves in the Brazilian Central Bank as a sign of market stability. Rather, they saw it as an opportunity to maintain the value of their investments by completely unloading their Brazilian assets in exchange for the freshly minted dollars. The bailout did not prevent the Brazilian economy from collapsing; it simply delayed its fall and protected the wealth of individual investors by offering them a final chance to dump their Brazilian assets before the Central Bank allowed the *real* to float and devalue.

C. ARGENTINA 2001

In order to determine the factors that caused the U.S. and the IMF not to offer Argentina a prompt and massive bailout during its economic crisis I offer this section as a historical primer. First, I will provide a narrative of the conditions leading up to the crisis. I will then detail the associated U.S. and IMF response to the crisis and the outcome of their choice.

⁴⁶ Paul Blustein, "U.S., IMF Announce Plan To Avert Brazilian Crisis; Loan Package Totals \$41.5 Billion," *The Washington Post*, November 14, 1998: A.01.

⁴⁷ Juan de Onis, "Brazil's New Capitalism," *Foreign Affairs*, May–June 2000: 107–119, 111.

1. Background Conditions and Economic Crisis

The popular connotation of Argentina's fall from its position as a neoliberal "poster child" to that of a risky "basket case" is indicative of the economic chaos and failure that befell the country in 2001. Not so long ago, in the early 1990s, Argentina's Washington Consensus-style economic policies and performance were highly touted by both the U.S. government and the IMF as the preeminent model for emerging markets to emulate.⁴⁸ Despite the free market "poster child" label often associated with the Argentine economy, many of the country's policies contradicted the free market principles that many people perceived it had adopted. However, these statements of support provided a necessary sense of market stability within Argentina that drew record amounts of foreign investment into the country. The recent economic crisis that hit Argentina in 2001 rapidly changed that perception of stability for the worse, and revealed the contradictions in its economic policies. These factors spooked investors who then sent their investment to more stable markets.

Argentina saw significant economic growth during President Carlos Menem's tenure as his nation's chief executive from 1989–1999. Between 1991–1997 Argentina's real GDP grew at an average rate of 6.1% and ranked at the top of Latin American economies.⁴⁹ The initial trigger for increased economic growth came from the recognition that continuous periods of hyperinflation would not attract investors. To address Argentina's perpetual concern with inflation, Menem and his Economy Minister, Domingo Cavallo, introduced the Convertibility Law.

Established in 1991, this law was designed to end Argentina's legacy of hyperinflation by strictly pegging the value of the peso to the dollar at a rate of 1:1. This policy effectively ended inflation and increased investor confidence in Argentina's market stability, but at the same time, it hamstrung the government's capacity to

⁴⁸ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 70.

⁴⁹ Geethanjali Nataraj and Pravakar Sahoo, "Argentina's Crisis: Causes and Consequences," *Economic and Political Weekly* (Economic and Political Weekly) 38, no. 17 (April 26–May 2 2003): 1641–1644, 1642.

influence the economy through monetary and exchange rate policies. Notably, the inflexible nature of their strict exchange rate policy limited the government's ability to react during a recession.

At first the Convertibility Law appeared to be exactly what Argentina needed to start its journey toward economic prosperity. It stopped the hyperinflationary trends that had plagued the country for many years. With inflation under control, the government began a series of reforms that lowered barriers to trade, privatized state-owned enterprises, and deregulated many sectors of the economy.⁵⁰ Privatization policies and continuous GDP growth increased the Argentina's attractiveness as an investment opportunity. The systematic liberalization of the market produced economic growth by attracting foreign money. Because of this apparent economic stability, investors bought Argentine assets rapidly.

If so many signs seemed to indicate economic progress why did an economic crisis strike Argentina? According to many economists, the two proximate causes of the economic crisis in Argentina were (1) an overvalued fixed exchange rate and (2) an excessive amount of foreign debt.⁵¹ These two conditions translated into a tangible problem that would affect a majority of Argentines.

Because the exchange rate was fixed at too high a level, Argentina exported too little and imported too much. This trade imbalance stood at - 829 million US\$ in 1999 and made it impossible for the country to earn the foreign exchange it needed to pay the interest on its foreign debt. Instead, Argentina had to borrow to meet those interest payments, causing the debt to grow even larger. The external debt as a percentage of GNP increased from 39.2 per cent in 1995 to 55.67 percent in 2000.⁵²

In spite of the tremendous growth and productivity increases that Argentina experienced in the 1990s, the Menem administration did not institute disciplined fiscal

⁵⁰ Paul Blustein, *And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina*, Kindle Edition (New York: Public Affairs, 2006), 3643–3649.

⁵¹ Geethanjali Nataraj and Pravakar Sahoo, "Argentina's Crisis: Causes and Consequences," *Economic and Political Weekly* (Economic and Political Weekly) 38, no. 17 (April 26–May 2 2003): 1641–1644, 1642.

⁵² Geethanjali Nataraj and Pravakar Sahoo, "Argentina's Crisis: Causes and Consequences," *Economic and Political Weekly* (Economic and Political Weekly) 38, no. 17 (April 26– May 2 2003): 1641–1644, 1642.

policies to reign in government spending. Fiscal discipline is an important principle to those who advocate orthodox economic reform. In fact, under Menem, Argentina continued to operate under significant budget deficits. During the times Argentina experienced economic growth, Menem should have produced a budget surplus to reduce the impact of potential future economic downturns. However, his government did not produce a single balanced budget or surplus during his entire tenure. In 1991 the deficit was 3.5% of GDP and grew to 6.4% of GDP in 2001. At the same time, the public debt grew from 38.8% of GDP (65 billion pesos) in 1991 to 64% of GDP (172 billion pesos) in 2001.⁵³ Coupled with increased national borrowing to pay debt, these massive budget deficits crippled Argentina's economy.

The IMF and investors in Argentina seemed to ignore these damning numbers and continued to believe in the sense of stability provided by the Convertibility Law. This belief would only last as long as the Argentine Central Bank could provide dollars in exchange for pesos. By 2000, Argentina's Central Bank had successfully defended the value of the peso in the wake of three major shocks to the international economic system: the Mexican Crisis in 1994, the Asian Crisis in 1997, and the Brazilian Crisis in 1998. Each time, this defense of the currency depended on the accumulation of even more foreign debt. In 2000, Argentina's financial situation was rapidly deteriorating as investors sold their emerging market assets en masse.⁵⁴ Investors then began to fear the grim data presented on the country's balance sheet.

The Clinton administration analyzed this situation and feared that the devaluation of Argentina's peso would shock the international economic system at a time that it could ill afford a crisis.⁵⁵ To forestall this scenario, Clinton supported an IMF brokered rescue package designed to protect the peso's value from collapsing. This package set aside

⁵³ Mark Allen, et al., *The Crisis That Was Not Prevented: Lessons for Argentina, the IMF, and Globalisation*, ed. Jan Joost Teunissen and Age Akkerman (The Hague: Forum on Debt and Development, 2003), 132.

⁵⁴ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 81.

⁵⁵ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 81.

\$20 billion in exchange for Argentina's agreement to a set of austerity measures designed to rein in debt and enforce fiscal discipline to raise revenue and reduce spending.⁵⁶

In the summer of 2001, billions of dollars left Argentina as investors converted their pesos for dollars. Seven billion dollars in Argentina's dollar reserves left the country in July alone. The money set aside for this loan could not get into the Argentine coffers fast enough. Even though about \$6 billion of this loan had been disbursed, President Fernando de la Rúa requested an immediate \$8 billion augmentation to the already scheduled loan designed to defend the peso. Without the disbursement of this additional money, de la Rúa feared a catastrophic economic meltdown in his country. This time, in order to increase the dollar amount of the IMF loan, Argentina would have to garner the support of the administration of the newly elected President of the United States, George W. Bush. The new administration was well known for its rhetorical support of free market principles and ideological disposition against bailouts.

2. U.S. and IMF Response

Upon receiving de la Rúa's augmentation request in August 2001, the IMF and its largest stakeholder, the United States Treasury, deliberated whether or not to continue support the Argentine government with additional loans that it claimed to need to stave off a severe and contagious financial crisis. Delegations from both the IMF and the U.S. Treasury Department were dispatched to Buenos Aires in order to assess the gravity of the economic situation and to lay out the terms and conditions required of Argentina in order to continue disbursement of their assistance package.

The debate inside the Bush administration regarding the bailout of Argentina was divided. While the Bush's Council of Economic Advisors advocated severing financial assistance to Argentina in order to end the era of Clinton-style bailouts and set a precedent for how it would deal with countries in similar fiscal situations, the other stakeholders in the argument argued for a program that would provide Argentina some

⁵⁶ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 81.

sort of assistance.⁵⁷ These other stakeholders were extremely valued by the Bush White House and included the Treasury Department, State Department, and the National Security Council. President Bush decided to defer his decision on an Argentine support package to the IMF.

While the IMF deliberated the fate of the Argentine bailout, a run on their banks started in late November. Determined to maintain convertibility, the de la Rúa administration instituted the *corralito* on December 1, 2001.⁵⁸ The *corralito* limited the amount of cash that Argentines could withdraw from their personal savings accounts to just \$250 per week. This decree also banned all transfers of money abroad that were not related to trade. This swift action by the government was designed to halt the run on banks that was in full swing across the nation. During the last three days of November alone \$3.6 billion dollars was withdrawn from accounts across the nation.⁵⁹ This policy choice also incited violent riots throughout the country that left more than a dozen citizens dead.⁶⁰

The *corralito* effectively destroyed the Argentine commitment to convertibility because people were no longer able to freely interchange pesos and dollars. It also occurred without consulting the IMF in advance.⁶¹ As a result, the IMF decided not to continue its support of Argentina with further loans. Finally, on December 5, 2001, the IMF cut off Argentina's financial lifeline by cancelling the previously scheduled loan installment of \$1.24 billion for a failure to comply with the agreed conditions.⁶² The United States agreed with the IMF assessment and similarly refused to continue to finance Argentina's government.

⁵⁷ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 82.

⁵⁸ Paul Blustein, *And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina*, Kindle Edition (New York: Public Affairs, 2006), 192.

⁵⁹ Paul Blustein, *And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina*, Kindle Edition (New York: Public Affairs, 2006), 182.

⁶⁰ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 71.

⁶¹ Paul Blustein, *And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina*, Kindle Edition (New York: Public Affairs, 2006), 203.

⁶² Steven Levitsky, "Argentina: From Crisis to Consolidation (and Back)," in *Constructing Democratic Governance in Latin America*, ed. Jorge I. Domínguez and Michael Shifter, 244–268 (Baltimore: The Johns Hopkins University Press, 2003), 259.

3. Outcome of the Policy Choice

The decision of the IMF and the Bush administration to decline Argentina's request for a bailout came as a surprise to President de la Rúa because of the precedents set by the bailouts given to Mexico in 1994 and Brazil in 1998.⁶³ The effects of the decision not to give Argentina a bailout were traumatic and dramatically affected the lives of Argentine citizens. Argentina's economy collapsed as a result of the IMF and U.S. decision not to provide Argentina with a bailout. This collapse caused civil unrest and political turmoil in Argentina.

The violent mass protests in late December 2001 led to the immediate resignation of President de la Rúa and Economy Minister Domingo Cavallo. Between December 21, 2001, and January 1, 2002, the Argentine Presidency changed hands five times, all within the legal framework of their constitution. Finally, hoping to end the political turmoil, Congress elected Eduardo Duhalde to the presidency on January 1, 2002.

On January 6, 2002, the Duhalde government devalued the peso and expunged the previously inviolable convertibility system that Argentina had championed for a decade. This necessary but painful decision caused the peso to fall from its long lasting parity with the dollar to a point in June 2002 where each peso was worth just 26 cents. The effects of this decision froze the ability of Argentina's banks to lend money and caused economic output to fall 11%. This, in turn, caused the rate of poverty in Argentina to soar to a point where nearly 60% of the population in Argentina was living below the poverty line.⁶⁴

⁶³ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 71.

⁶⁴ Paul Blustein, *And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina*, Kindle Edition (New York: Public Affairs, 2006), 3731–3734.

THIS PAGE INTENTIONALLY LEFT BLANK

III. ANALYSIS

This section will thoroughly analyze the three cases—Mexico, Brazil, and Argentina—utilizing the three hypotheses selected to explain the variation found in the historical policy decisions made to address economic crises.

A. HYPOTHESIS 1: GEOPOLITICAL SIGNIFICANCE OF THE COUNTRY

The first hypothesis predicts that a country that is more geopolitically and economically significant to the interests of the United States will be more likely to receive a bailout in the event of an economic crisis. Conversely, a country of little geopolitical or economic significance to the United States will be more unlikely to be denied a bailout in the event of an economic crisis. The most important measures I will use to assess a country's significance include the degree of trade with the United States, economic and political interdependence with the United States, and policymaker statements. An examination of Mexico, Brazil, and Argentina during economic crisis is relevant in explaining the variation in the resulting policy choices made across country cases. This analysis will reveal that Mexico and Brazil were deemed geopolitically significant, while Argentina was not. Therefore, the cases lend support for the hypothesis.

1. Mexico

The geopolitical significance of Mexico to the United States is tremendous, thereby lending support to the hypothesis. This geopolitical significance stems from the high degree of trade, a shared border, common problems requiring cooperative efforts, and the importance of Mexico's economic success to domestic U.S. markets. The impact of an economic crisis in Mexico would threaten U.S. market stability and its domestic economy in general. An additional measure of geopolitical significance is how supportive a nation is for U.S.-led initiatives in recognized international forums.

Both Mexico and Brazil have large, established trading relationships with the United States. Argentina does not. To support this claim, the following data regarding

trade statistics for each country with respect to their imports to the U.S. and exports from the U.S. from 1992–2002 is presented.⁶⁵ During these years, imports from Mexico to the United States ranged between \$35 billion to nearly \$136 billion. Imports from Brazil to the United States ranged between \$7.4 billion to nearly \$16 billion. At the same time, imports from Argentina ranged between \$1.2 billion to \$3.3 billion. Exports from the United States to Mexico during this same time period ranged between \$40.5 billion to \$111.3 billion. In Brazil, these exports ranged between \$5.7 billion to \$15.8 billion. At the same time in Argentina, these exports ranged between \$1.6 billion to \$5.8 billion.

Mexico obviously dominates the scene as the United States' number one trading partner in Latin America. However, Brazil is the United States' second largest trading partner in Latin America, largest South American trading partner, and has become increasingly important over time. Its trade relationship with the United States is 5 times larger than Argentina's trade relationship with the United States. Argentina's impact on the U.S. economy is negligible. In all three periods of economic crisis we see a decline in that particular nation's ability to buy U.S. goods. With these trade factors in mind, Argentina's inability to buy U.S. goods or offer a comparative advantage in other sectors relative to Mexico and Brazil increasingly reduces their relative worth to U.S. policymakers when deciding on where to invest.

At the time of the peso crisis, Mexico's importance as a dominant trading partner with the United States was solidified with the implementation of NAFTA that very same year. In 1994, Mexico was the United States' third largest trading partner, behind Japan and Canada. At the same time, the United States was Mexico's largest trading partner.⁶⁶ The robust nature of the trade relationship connecting between these two countries is indicative of a high degree of associated economic and geopolitical significance. The U.S. imported goods totaling approximately \$49 billion in 1994 and \$62 billion in 1995

⁶⁵ Office of Trade and Industry Information (OTII), Manufacturing and Services, International Trade Administration, U.S. Department of Commerce. Source: Foreign Trade Division, U.S. Census Bureau, <http://tse.export.gov> (accessed August 30, 2009).

⁶⁶ David Gould and Michelle Thomas, "Beyond the Border: A Look at the Top U.S. Trading Partners," *The Southwest Economy* (Federal Reserve Bank of Dallas), no. 6 (November/December 1995): 10.

from Mexico. Exports to Mexico from the U.S. totaled approximately \$51 billion in 1994 and \$46 billion in 1995.⁶⁷ The high degree to which the economies of the U.S. and Mexico are intertwined by trade creates a situation where both crisis and prosperity in one of the countries will similarly affect the other country. Therefore, ending or even preventing crisis and promoting prosperity in either country is a logical aim for U.S. policymakers.

At 3,141 kilometers in length, the border between the United States and Mexico is the ninth longest in the world. This vast border sees over 1,000,000 legal crossings per day.⁶⁸ The necessity of a cooperative relationship between the governments of the United States and Mexico is becoming increasingly significant to policymakers, as various interest groups have emerged to impact the manner in which the U.S. deals with issues pertaining to its southern neighbor. These interest groups are extremely varied and include labor unions and corporate lobbyists, American nativists and recent Mexican immigrants. Recognizing and understanding the high degree of cultural, industrial, economic, and municipal interdependence of both nations along the border area, colloquially and regionally known as MexAmerica, improves the knowledge of those in a position to craft formal foreign policy that is consistent with the informal structures and practices of the regional municipalities already in place. These actualities formally increase Mexico's geopolitical significance to U.S. policymakers.

As a result of their close proximity to one another, Mexico and the United States face many common problems that require cooperative solutions. Cooperation among policymakers ensures a greater degree of interdependence by integrating the efforts of both nations to seek solutions that benefit both nations. The problems they face range from criminal to political to economic issues, including: drug trafficking, immigration, and advancing free trade policies. The high degree of cooperative efforts and interdependence between the two nations is a tangible measure of Mexico's value to the

⁶⁷ Office of Trade and Industry Information (OTII), Manufacturing and Services, International Trade Administration, U.S. Department of Commerce. Source: Foreign Trade Division, U.S. Census Bureau, <http://tse.export.gov> (accessed August 30, 2009).

⁶⁸ Fernando Romero, *Hyperborder: The Contemporary U.S.— Mexico Border and its Future* (New York, NY: Princeton Architectural Press, 2008), 9.

U.S. Recent cooperative policies enacted by the two governments include: The Smart Border Agreement, Operation Against Smugglers (and Traffickers) Initiative on Safety and Security (OASISS), Security and Prosperity Partnership of North America (SPP), and the Action Plan to Combat Border Violence and Improve Public Safety. Therefore, Mexico is highly likely to be considered geopolitically significant to the United States and would be given assistance in times of crisis.

International politics must also be considered when deciding whether or not a bailout will be issued. Strom Thacker posits that, “Special treatment received by any particular debtors may be better explained by political factors than by their position in the international financial system or their relationship with creditor banks.”⁶⁹ Mexico’s record of alignment with U.S.-supported initiatives in recognized international forums leading up to the peso crisis are tepid at best. In the United Nations (U.N.), Mexico votes against the United States in more than one-half of all votes (62% in a 1997 study).⁷⁰ One factor that would mitigate Mexico’s tepid support of the U.S. in the U.N. is the ratification of NAFTA. This is the most significant economic agreement that Mexico possesses, since the U.S. is its largest trading partner.

Another logical way to assess Mexico’s voting record in the U.N. is that it opposes the United States because it is a geopolitically significant sovereign power. As such, Mexico can vote its interests and not worry about placating the United States. Therefore, even though Mexico does not support the U.S. in the U.N. at all times, it remains geopolitically significant as a result of either its massive free-trade agreement or its ability to vote its own interests in international forums.

Mexico is geopolitically significant and therefore supports the hypothesis that a geopolitically significant country will receive a bailout. The U.S. and the IMF bailed out Mexico from its economic crisis because it was geopolitically significant enough to provoke their action.

⁶⁹ Strom C. Thacker, “The High Politics of IMF Lending,” *World Politics* (The John's Hopkins University Press) 52, no. 1 (October 1999): 38–75, 58.

⁷⁰ Bryan T. Johnson, “U.S. Foreign Aid and United Nations Voting Records,” *The Heritage Foundation*, June 12, 1998, <http://www.heritage.org/research/tradeandeconomicfreedom/bg1186.cfm> (accessed August 30, 2009).

2. Brazil

The geopolitical significance of Brazil to the United States is tremendous and lends support to the hypothesis. Although the U.S. trade relationship with Brazil was not nearly as robust as the U.S. trade relationship with Mexico at the moment of crisis, many other factors demonstrate Brazil's geopolitical significance. These factors include the size and diversified nature of its economy, its large population, and its dominant role in South American politics. The impact of an economic crisis in Brazil threatens regional market stability by hamstringing the economies of the other South American economies. An additional measure of geopolitical significance is how a nation votes with respect to U.S.-led initiatives in recognized international forums.

Of major significance, Brazil's population of 165 million is the largest in South America and the fifth largest in the world.⁷¹ A population this large presents an ideal opportunity for investors to grow new markets and expand industrial capacity. Additionally, the economy of Brazil was the tenth largest in the world in 1999; which even exceeded the size of the Russian economy.⁷² Brazil's economy is the most diversified and industrialized economy in South America. Rich in natural resources and industrial capacity, many of their industrial and service products compete well internationally. The service sector of the Brazilian economy is highly advanced and comprises 65.8% of GDP. Notable aspects of its service sector are banking and telecommunications. Its industrial sector is similarly advanced and makes up 28.7% of GDP.⁷³ The goods from this sector are wide-ranging and include everything from shoes to petrochemicals and commercial aircraft. These industries are much more advanced than the simple *maquiladora* assembly plants found in Mexico. A population of this magnitude coupled with its large, industrial economy has the potential to become an important and sturdy market for consumers and labor alike. Juan de Onis claims that out of all the "big emerging markets," China, India, and Indonesia included, Brazil's

⁷¹ These population statistics are from 1999. Current data sizes their population at more than 190 million.

⁷² Juan de Onis, "Brazil's New Capitalism," *Foreign Affairs*, May–June 2000: 107–119, 109.

⁷³ Bureau of Western Hemisphere Affairs, "Background Note: Brazil," *U.S. Department of State*, July 2009, <http://www.state.gov/r/pa/ei/bgn/35640.htm> - econ (accessed October 5, 2009).

economic and political prospects for becoming a modern, "first world" economy are the highest. Bearing witness to this fact is the \$300 billion in foreign investment that had been sent to Brazil by the year 2000.⁷⁴

The U.S. trade relationship with Brazil, although not as intense as the relationship with Mexico, remains important. Outside of Mexico, Brazil is the United States' largest Latin American trading partner. From 1997–1998, the U.S. imported over \$19 billion in goods from Brazil and exported over \$31 billion.⁷⁵ According to current U.S. census data, Brazil is the United States' tenth largest trading partner in the world with a trade relationship valued at over \$21 billion through June 2009. Although the U.S. trade relationship with Brazil is not of the same magnitude or maturity as its relationship with Mexico, Brazil is the United States' largest trading partner in South America. Therefore, Brazil has been and remains economically significant to the interests of the United States.

Another point of relevance related to Brazil comes from its geographic location within South America. Brazil borders nine other nations and occupies over half of the South American continent. These nine other nations are key to Brazil's ability to increase its exports and grow its economy. Nine individual border nations provide Brazil with an opportunity to sell the wide-ranging products created by its industrial base. As an emerging market, this geographic relevance provides a situation where the potential for market expansion is tremendous. Consequently, the economic crisis that struck Brazil had a severe negative impact on the smaller economies that it shares a border with. This crisis reduced investor confidence regionally and caused massive capital outflows. A good measure of this effect is GDP. Latin America's GDP grew 5.3% in 1997, diminished to 2.3% in 1998, and in 1999 regional plummeted to just 0.3%.⁷⁶

⁷⁴ Juan de Onis, "Brazil's New Capitalism," *Foreign Affairs*, May–June 2000: 107–119, 109.

⁷⁵ TradeStats Express™, <http://tse.export.gov> (accessed October 31, 2009).

⁷⁶ Humberto Campodonico and Manuel Chiriboga, "Third World Network," *The Financial Crisis of Latin America and the New International Financial Architecture*, September 6, 2000, <http://www.twinside.org.sg/title/twr122f.htm> (accessed October 31, 2009). This is the edited text of an introductory paper by the authors to a seminar on The New International Financial Architecture and Latin America organized by ALOP (Latin American Association of Promotion Organizations) with the support of OXFAM-America, held in Lima on 6–8 September 2000.

Even though Brazil does not support the U.S. in the U.N. most of the time, it remains geopolitically significant as a result of its role as a stabilizer within MERCOSUR and South America more generally. Brazil's record of alignment with U.S. initiatives in recognized international forums leading up to the economic crisis is weak. In the U.N., Brazil voted against the United States more than half the time (57% in this 1997 study).⁷⁷ As with Mexico, a geopolitically significant nation can oppose the United States in international forums in order to demonstrate its sovereignty and forward its interests.

In addition to U.S. trade interests and international politics, there is also the question of whether—and the extent to which—the nation requesting a bailout mitigates the risk by pledging collateral or demonstrating some degree of political institutional stability. More collateral in a more stable, and therefore investor-friendly, political environment, might encourage the U.S. government to go through with the bailout. Mexico offered up its massive oil reserves as collateral for the loan: “The United States designed the support package as a straight business deal: (1) it required Mexico to pay interest and fees on medium-term swaps; (2) it made disbursement of funds contingent on “certification” of Mexico's adherence to strict IMF monetary targets; and (3) it took the revenues from Mexican oil exports as collateral.”⁷⁸ In contrast, Brazil's government did not pledge anything as collateral and still received the bailout package. However, Brazil was politically stable, and market-friendly, as is indicated by the reelection of Fernando Henrique Cardoso as President in 1998.

One additional international political factor that demonstrates Brazil's significance is its position as the largest economy in the **Common Market of the South** (MERCOSUR). MERCOSUR is the largest trading block in South America and the

⁷⁷ Bryan T. Johnson, “U.S. Foreign Aid and United Nations Voting Records,” *The Heritage Foundation*, June 12, 1998, <http://www.heritage.org/research/tradeandeconomicfreedom/bg1186.cfm> (accessed August 30, 2009).

⁷⁸ Springer and Molina, 66.

world's fifth largest trading bloc. Brazil's power within MERCOSUR has helped keep the organization focused on South American free trade and away from the political affairs championed by Venezuela.⁷⁹

The factors outlined above clearly indicate Brazil's prominence, both politically and economically, in Latin American stability. Clinton's Treasury Secretary, Robert Rubin said, "While there are no certainties, we believe that this is the right program both for the people of Brazil and for the economic well-being of the American people."⁸⁰ His statement ties the health of the U.S. economy to that of the Brazilian economy and signifies Brazil's significance in the eyes of the Clinton administration. Louis Uchitelle quotes an economist from a prominent Wall Street firm as saying, "It is very clear from the statements being made by top officials in the Clinton Administration that Brazil is fundamental to the system. There is just no way they can allow Brazil to fail."⁸¹ The statements from senior Clinton administration officials and the analysis of these statements by major financial houses demonstrate that Brazil is geopolitically significant to the United States and that this particular case supports the hypothesis. The U.S. and the IMF bailed out Brazil from its economic crisis because it was geopolitically significant enough to provoke their action.

3. Argentina

The case for Argentina's geopolitical insignificance is as strong as the case for the geopolitical significance of both Mexico and Brazil. Argentina's small population, relative isolation from U.S. markets, temporary political instability, and lack of support for U.S.-led initiatives in recognized international forms severely limits its effect on the global economy and political situation. The impact of an economic crisis in Argentina would likely be isolated to its borders and have little if any adverse effect on the United

⁷⁹ Joanna Klonsky and Stephanie Hanson, "Mercosur: South America's Fractious Trade Bloc," *Council on Foreign Relations*, August 20, 2009, <http://www.cfr.org/publication/12762/> (accessed September 4, 2009).

⁸⁰ David E. Sanger, "Brazil Bailout: 2 Gambles for U.S.," *New York Times*, November 14, 1998, Late Edition (East Coast) ed.: A.4.

⁸¹ Louis Uchitelle, "Calculated Risk: U.S. and I.M.F. Lead Push for Brazil Bailout Plan," *New York Times*, September 28, 1998, Late Edition (East Coast) ed.: A.1.

States economy. Therefore, because Argentina is of little geopolitical significance to the United States it did not receive a bailout and lends further support to this hypothesis.

In 2001 Argentina maintained a population of just 35 million people.⁸² As such, its potential to develop a robust market relationship with the U.S. is severely limited, especially when compared throughout Latin America to the large established trading relationships it maintains with Mexico and Brazil.⁸³ Argentina's ability to find a comparative advantage in trade with the United States is further hampered by the notoriously rigid nature of its labor laws and strong union pressures.⁸⁴ Without a common border or structured free trade agreement, U.S. trade with Argentina was negligible. Rather than engage in trade with Argentina, it was more efficient for the United States to either produce domestically or import from other emerging markets. These facts surrounding the trade relationship limit Argentina's geopolitical significance.

A potential mitigating factor for a nation of seemingly low geopolitical significance is its support of the initiatives promoted by the United States in recognized international forums. These votes can help sway the opinion of the U.S. government when considering a bailout. Argentina's record of voting with the U.S. in the U.N. is relatively weak and inconsistent. In fact in a 1997 study, Argentina voted against U.S. initiatives in the U.N. 44% of the time.⁸⁵ A nation of relatively low geopolitical significance like Argentina with few other options to garner economic support from the United States may have been able to turn political capital gained by voting more frequently for the initiatives developed and supported by the U.S. in the U.N. into approval of its bailout augmentation request.

Following the decision in December 2001 by the IMF and the United States to deny the Argentine loan request, political turmoil struck the country. The revolving door

⁸² Martin Feldstein, "Argentina's Fall: Lessons from the Latest Financial Crisis," *Foreign Affairs* (Council on Foreign Relations) 81, no. 2 (March–April 2002): 8–14, 8.

⁸³ See this data on 27.

⁸⁴ Feldstein, 10.

⁸⁵ Bryan T. Johnson, "U.S. Foreign Aid and United Nations Voting Records," *The Heritage Foundation*, June 12, 1998, <http://www.heritage.org/research/tradeandeconomicfreedom/bg1186.cfm> (accessed August 30, 2009).

of the presidency saw five transfers of power in just a two-week period. This period was marked by violent protest and general instability. These actions may have officially ended the close debate within the Bush administration regarding their stance on administering some sort of aid to Argentina. Even though the transfers of executive power were accomplished in accordance within the scope of their Constitution's authority, an outsider would have judged the situation as chaotic and stereotypical of weak Latin American governments. In fact, Paul Blustein notes that during this debate some administration officials stated, "Argentina's geopolitical significance paled by comparison with Turkey's, so if the Bush team was going to take a stand against bailouts, Argentina would be a good place to do it."⁸⁶ Additionally, the rhetoric in Argentina at the time of their crisis claimed that the U.S. abandoned them because their country was "not of geopolitical significance."⁸⁷

In the case of the economic crisis that occurred in Argentina in 2001, a bailout was not issued due to its relatively low geopolitical significance. Therefore, in this case, the hypothesis is supported.

4. Hypothesis Validity

The first hypothesis predicts that a country that is more geopolitically and economically significant to the interests of the United States will be more likely to receive a bailout in the event of an economic crisis. Conversely, a country of little geopolitical or economic significance to the United States will be more unlikely to be denied a bailout in the event of an economic crisis. A comparative analysis of the cases of Mexico, Brazil, and Argentina during economic crisis explained the variation in the resulting policy choices made across country cases. This analysis revealed that Mexico and Brazil were geopolitically significant to the United States, while Argentina was not. Accordingly, the Geopolitical Significance hypothesis is supported by the comparison.

⁸⁶ Paul Blustein, *And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina*, Kindle Edition (New York: Public Affairs, 2006), 2377.

⁸⁷ Feldstein, 8.

B. HYPOTHESIS 2: U.S. EXECUTIVE IDEOLOGY

This hypothesis states that the political ideology and belief system of the U.S. President is a major causal factor that determines whether or not a bailout will be given to a nation in the midst of an economic crisis. A president ideologically committed to utilizing the bailout as a policy tool will be more likely issue a bailout in the event of an economic crisis. Conversely, a president ideologically opposed to utilizing the bailout as a policy tool will be more unlikely to deny a bailout to a country experiencing an economic crisis. An examination of Mexico, Brazil, and Argentina during economic crisis is relevant in explaining the variation in the resulting policy choices made across time and presidency. The logic of the comparative method reveals that the variation in these three country cases cannot be explained by presidential ideology and must be ascribed to other factors.

1. Mexico

The ideology and political will of President Clinton and his administration appeared to play a large role in ensuring that the Mexican economy would be bailed out following the 1994 crisis. His personal belief in NAFTA's potential for success, even though it was contested among members of his own party, drove him to provide Mexico a bailout, even though the U.S. Congress rejected it. His determination to see the bailout through, even without legislative support, is indicative of the crucial role of the ideology and personal beliefs of the White House in this case in determining to whom a bailout should be issued.

Originally an idea proposed by President Salinas in Mexico, NAFTA promised to increase economic benefits to each of its three members. Even though it promised to bring the theoretical benefits of free trade to all three North American countries, NAFTA, initially, was not overwhelmingly popular with the American people or their representatives in congress. In fact, ratification of NAFTA passed the House by a slim margin, 234-200.⁸⁸ The implementation of NAFTA by U.S. lawmakers came at the

⁸⁸ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 58.

expense of a large amount of political capital by President Clinton, who received 102 votes for and 156 votes against the treaty from representatives of his own party in the House vote.⁸⁹ Because of the strong opposition in his own party, Clinton was more inclined to ensure the success of the treaty by mitigating anything that may cause it setbacks or threaten its chances for success. The tremendous amount of political capital Clinton spent in ensuring NAFTA's passage could not be wasted on the initiative's failure so soon after its implementation.

When the Congress rejected Clinton's bailout proposal, he moved swiftly to leave Congress on the sidelines and secure a rescue passage by utilizing funds from the ESF. This move was bold and ensured that Clinton alone would be responsible for the success or failure of this policy choice. This action to bypass congress and "go it alone" is a clear demonstration of the large impact a President's ideology and belief system plays in determining who should receive a bailout.

President Clinton's own statements regarding this bailout further support this argument. He said, "We simply couldn't stand aside and let Mexico fail without trying to help," and explained that he wanted to reverse the selfish and shortsighted nature of American foreign policy in Latin America.⁹⁰ His ideological convictions towards reducing Latin American resentment of America impacted his policy choice to bail out Mexico.

The hypothesis that bailouts can be explained by the executive's ideological stance, therefore, finds support in the Mexican case. President Clinton's legacy would, in no small part, be determined by the success or failure of NAFTA due to the large amount of effort he spent in ensuring its passage. To protect this legacy, Clinton undertook huge political risk by ensuring an unpopular policy choice was implemented when he invoked the ESF and ensured a bailout to Mexico. These actions by the President clearly show the validity of this hypothesis in the case of policy response to Mexico's peso crisis in 1994.

⁸⁹ "Final Vote Results For Roll Call 575," *Office of the Clerk, U.S. House of Representatives*, November 17, 1993, <http://clerk.house.gov/evs/1993/roll575.xml> (accessed August 28, 2009).

⁹⁰ Bill Clinton, *My Life: The Presidential Years, Volume 2* (New York, New York: Random House, 2005), 233.

2. Brazil

The case of Brazil's economic crisis and U.S. response adds further support the notion that the political ideology and belief system of the U.S. President is the major factor that determines whether or not a bailout will be given to a nation in the midst of an economic crisis. The ideology and political will of President Clinton and his administration played a large role in ensuring that the Brazilian economy would be bailed out in the midst of the 1998 crisis. His personal belief in utilizing the bailout as a key part of economic policy is indicated by his willingness to use it on so many occasions. Regarding the bailout to Brazil, Clinton stated that it was, "consistent with our new policy of trying to prevent failure and its spread to other nations."⁹¹ His Treasury Department worked closely with the IMF to design and implement bailouts to many countries in economic crisis. His determination to implement massive rescue packages, even without legislative support in most cases, is indicative of the crucial role of the ideology and personal beliefs of the President in determining when and to whom a bailout should be issued.

The regularity of Clinton era bailouts adequately represents his belief in their usefulness. Following the bailout given to Mexico, the Clinton administration designed and supported IMF sponsored bailouts to many nations throughout Asia during the 1997-1998 regional financial crisis. These bailouts totaled \$125.3 billion with \$57 billion of that total going to South Korea alone.⁹² After these bailouts were issued, another massive bailout totaling \$22 billion was created and sent to Russia in the summer of 1998.⁹³

Clinton again avoided congressional confrontation by utilizing the Treasury Department to more readily implement his policy choices. Through the Treasury, Clinton was able to use the ESF at will and effectively remove the Congress' responsibility for

⁹¹ Bill Clinton, *My Life: The Presidential Years, Volume 2* (New York: Random House, 2005), 479.

⁹² IMF Staff, "Recovery from the Asian Crisis and the Role of the IMF," *International Monetary Fund*, June 2000, <http://imf.org/external/np/exr/ib/2000/062300.htm> (accessed September 4, 2009).

⁹³ Paul Blustein, "U.S., IMF Announce Plan To Avert Brazilian Crisis; Loan Package Totals \$41.5 Billion," *The Washington Post*, November 14, 1998: A.01.

oversight of tax dollar appropriation. Additionally, the U.S. Treasury worked closely with the IMF to design and finance the non-U.S. portion of the bailouts. These steps to bypass traditional and legitimate checks on executive authority to ensure the President's choice of policy boldly demonstrate Clinton's ideological commitment to the bailout as an appropriate option for nations mired in economic crisis.

The hypothesis that ideology matters finds further support in the decision by President Clinton to support the Brazilian bailout. Clinton's widespread use of the bailout as a policy option both inside and outside of Latin America are representative of his personal beliefs in its effectiveness.

3. Argentina

This hypothesis states that the political ideology of the U.S. President is the major factor that determines whether or not a bailout will be given to a nation in the midst of an economic crisis. The presidency of George W. Bush was vastly different from that of the Clinton presidency in terms of its willingness to utilize the bailout as a regular tool of foreign policy. As previously demonstrated, President Clinton's administration regularly utilized bailouts in attempts to forestall economic crises throughout the world. A major shift in this form of policy occurred under the Bush administration and its *realpolitik* view of foreign policy. The new President was deeply skeptical toward the use of bailouts as policy tool and sought to avoid using American tax dollars to pay for what he perceived as poor decisions made by the leaders of other nations.⁹⁴ Although the previous statement can be construed as fact based on the administration's rhetoric, its actions in other cases appear to violate those same principles and invalidate the usefulness of this hypothesis as the primary causal factor in determining which countries should receive a bailout.

For the purpose of this thesis, I will discriminate between bailouts of foreign nations and domestic industries and corporations. Analyzing the policy of a bailout issued to an industry in a domestic context is not a valid comparison to make over time

⁹⁴ Steven Levitsky, "Argentina: From Crisis to Consolidation (and Back)," in *Constructing Democratic Governance in Latin America*, ed. Jorge I. Domínguez and Michael Shifter, 244–268 (Baltimore: The Johns Hopkins University Press, 2003), 257.

and in contrast with the bailout of a foreign nation. Therefore, I will limit this analysis to the Bush administration's use or nonuse of the bailout relative only to foreign policy conducted by states and international organizations.

In spite of its ideological and rhetorical opposition toward the bailout as a foreign policy tool, the Bush administration used it on many occasions. The most notable occasions germane to this discussion happened in Latin America and at nearly the same time Argentina's request for an additional bailout was denied. In August of 2002, Bush's Treasury Secretary, Paul O'Neill, supported IMF brokered assistance packages for both Brazil and Uruguay. With respect to Brazil, O'Neill stated, "I continue to favor support for Brazil and other nations that take appropriate steps to build sound, sustainable and growing economies." He also commented that, "Uruguay deserves the ongoing support of the international financial community for its commitment to sound economic policy."⁹⁵ The same article was noticeably absent remarks regarding a bailout for Argentina who was also in the middle of a deep economic crisis.

The Brazilian and Uruguayan cases demonstrate that although the Bush administration was ideologically opposed to bailouts in general, the use of a bailout use as a tool of foreign policy was not off the table. In fact, O'Neill's comments indicate that the administration's willingness to support a bailout for a nation hinged on the perception, be it real or imagined, that the nation's economic practices were sound, sustainable, and realistic. The Bush administration's use of the bailout as a policy tool was not driven solely by blanket ideology. Therefore, this hypothesis is not supported in the case of Argentina's denied bailout.

4. Hypothesis Validity

The ideological convictions of American presidents do not offer sufficient explanation in determining whether or not a bailout will be issued to a country experiencing an economic crisis. Former President William J. Clinton offered a bailout to Mexico and Brazil, while former President George W. Bush refused a bailout to Argentina.

⁹⁵ Richard W. Stevenson, "U.S., in Shift, Says It Backs Latin Bailouts," *New York Times*, August 2, 2002, Late Edition (East Coast) ed.: C.1.

Clinton, who had much political capital invested in NAFTA, was focused on the crises' risk to the U.S. economy and to proving the viability of free trade as a preferred policy measure. Due to the increasingly interdependent nature of the trade relationships, his administration supported the idea that foreign bailouts were an integral part of reducing the potential of the devastating effects of an economic crisis from spreading across national borders. Clinton proved his belief in this policy by boldly advocating the bailout to Congress and then acting on it alone when Congress failed to support his policy choice with respect to the Mexican economic crisis in 1995. A Republican Congress unwilling to approve a bailout for Mexico was trumped by Clinton's utilization of the ESF to fund the relief.

The Bush administration handled Argentina's economic crisis a different perspective. Steven Levitsky argued, "The Bush administration combined a deep skepticism toward bailouts . . . with a narrow *realpolitik* foreign policy vision."⁹⁶ This administration did not want to provide nations practicing what they perceived as poor economic policy with an automatic bailout. With an ideological predisposition against "handouts," this administration would not reward bad behavior.⁹⁷ Despite its ideological rhetoric denouncing bailouts, the Bush White House supported IMF designed bailouts for both Brazil and Uruguay in 2002. This is particularly puzzling since Argentina had often been touted as the Latin American model for Washington Consensus-style economic reform in the 1990s and the Bush administration would not call these sorts of reforms bad behavior or poor economic policy. "Perhaps more than any other country in the region, Argentina's economic officials dutifully implemented the free market policies such as trade liberalization that were encouraged by the U.S. government and private banks."⁹⁸ In fact, "from 1991 to 1998 the economy grew at an average rate of 6% a year, reaching a total gross domestic product of nearly \$300 billion, with almost no inflation."⁹⁹ All of

⁹⁶ Steven Levitsky, "Argentina: From Crisis to Consolidation (and Back)," in *Constructing Democratic Governance in Latin America*, ed. Jorge I. Domínguez and Michael Shifter, 244–268 (Baltimore: The Johns Hopkins University Press, 2003), 257.

⁹⁷ Crandall, 73.

⁹⁸ Crandall, 70.

⁹⁹ Paul Blustein, *And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina*, Kindle Edition (New York: Public Affairs, 2006), 257–267.

these are generally considered signs of economic health and align with the ideology of a conservative president. Despite these market reforms, Argentina never resolved its fiscal policy and continued to increase its deficit each year. Therefore, although the ideology of the ruling leader may play a role in determining the likelihood of a bailout's approval in some cases, it does not appear to provide sufficient cause to generalize it as the determining factor in deciding the outcome of a request for a bailout. Thus the comparison of these three cases eliminates this hypothesis as the causal factor in determining who should receive a bailout.

C. HYPOTHESIS 3: U.S. EXECUTIVE LEARNING FROM PAST POLICY CHOICES

Policymakers determine policy based on the lessons they have learned from past policy decisions regardless of whether or not the “right lessons” are learned and applied. This hypothesis states that political leaders in the United States learn from the results of past policy decisions and apply those lessons when determining whether or not a bailout will be issued to a nation experiencing an economic crisis. An examination of Mexico, Brazil, and Argentina during economic crisis is relevant in explaining the variation in the resulting policy choices made across time and presidency. This analysis will reveal that policy learning occurred in all three cases.

1. Mexico

The bailout issued to Mexico following its 1994 peso crisis was, at the time, the largest financial assistance package ever issued to a nation enduring an economic crisis. A loan of \$52.8 billion to a failed economy within a month of its collapse is a risky venture, especially in an emerging market. “Learning need not be restricted to learning about policy tools or interventions. Learning can entail new or reaffirmed understanding of policy problems or objectives.”¹⁰⁰ President Clinton believed that the United States often “got what it deserved” when its policy choices towards Latin America were shortsighted and selfish, and he sought to redress these policy shortcomings with policies

¹⁰⁰ Peter J. May, “Policy Learning and Failure,” *Journal of Public Policy* (Cambridge University Press) 12, no. 4 (October-December 1992): 331–354, 334.

based on honest friendship and not an unequal partnership.¹⁰¹ That said, to examine whether this policy was a result of learning from past policy or lack of appropriate policy, I will examine the Mexican bailout with respect to the Latin American debt crisis in the 1980s and the associated policy response by the U.S. government and the IMF.

The Latin American debt crisis officially began in August 1982 when Mexico's government announced that it would no longer be able to service its debt.¹⁰² Important similarities surrounding this crisis can be applied to the peso crisis in 1994. Massive depreciation of the peso coupled with depletion of the Central Bank's foreign reserves caused investors and banks to become wary. This situation led commercial banks to refuse financing to Mexico and essentially halted Mexico's ability to trade.

A series of short-term, high interest loans issued by the Mexican government to investors continued to deplete Mexico's reserves and failed to address the problem appropriately. The economic situation in Mexico became very dire as it slowly achieved enough growth from trade to cover the interest on its external debt. Restructuring debt and economic policies continued at a sluggish pace throughout the 1980s without much success. The restructuring served to pay the interest on previously scheduled loans and created a situation where the debt burden was so large it could not possibly be paid back. Regionally, the interest alone on foreign loans amounted to 5% of gross domestic product (GDP). This system of chasing loans with more loans became a vicious cycle that was completely unsustainable. The Mexican economy served only to pay interest to its creditors and could not make necessary investments toward lasting development. This form of support clearly did not work to address the crisis and limit its duration and spread.

¹⁰¹ Bill Clinton, *My Life: The Presidential Years, Volume 2* (New York, New York: Random House, 2005), 233.

¹⁰² Alexander Theberge, "The Latin American Debt Crisis of the 1980s and its Historical Precursors," *Working Paper*, April 8, 1999, <http://www.columbia.edu/~ad245/theberge.pdf> (accessed August 29, 2009), 9. Tones have been written on the Latin American debt crisis in the 1980s. My intention in this paper is to condense the debt crisis into a workable summary relevant to policy learning with respect to the peso crisis. I do not mean to gloss over the debt crisis in an overly simplistic manner. This paper does not specifically deal with the debt crisis and will avoid getting bogged down into its more complex arguments. Theberge provides an excellent summary of the events leading up to the debt crisis. The facts and numbers I use to explain the debt crisis come from his work.

Retrospectively, an argument can be made to support an immediate bailout of Mexico in 1982. This swift and massive loan would have likely dampened the effects of the crisis and erased the negative effects of compiled interest accumulation from the series of short-term and high-interest loans issued by a hodgepodge of lenders throughout the 1980s. The impact of the debt crisis on the United States reduced Mexico's ability to buy U.S. goods and also increased illegal immigration.

The results from the debt crisis and the reference to the 1980s as the "lost decade" in Latin America provide a convincing case for the willingness of the Clinton administration to select some form of a policy choice that could prevent a repeat of the previous decade's poor economic performance and adverse impact on the United States. President Clinton believed that an economic crisis in Mexico would reduce trade between the two countries, cause a 30% rise in illegal immigration, and increase the power of Mexico's drug cartels.¹⁰³ By swiftly choosing to bailout Mexico in 1994, Clinton demonstrated an unwillingness to accept a slow and protracted recovery in Mexico and to prevent the economic crisis from spreading throughout the region as it did in the 1980s. Therefore, the Mexican peso crisis adds support to this hypothesis.

2. Brazil

Political leaders in the United States that learn the "right" lessons from the results of past policy decisions are better equipped to determine when and if a nation should receive a bailout. Learning implies that the political leaders are able to analyze the outcomes of past policy decisions as points of reference that can be used to make future policy decisions when presented with similar situations and circumstances. In this analysis of the bailout given to Brazil, many contemporary comparisons exist to help examine the details of the conditions that led to the bailout. At the time that this bailout was announced David Sanger wrote that this policy to calm the global financial markets

¹⁰³ Bill Clinton, *My Life: The Presidential Years, Volume 2* (New York, New York: Random House, 2005), 231.

was a gamble that hoped to succeed where others failed.¹⁰⁴ This statement implies that the policy decision to bail out a nation preemptively had been tried recently with lackluster results. In fact, the Clinton administration's prolific support of the bailout as a policy tool provides this analysis many cases to observe whether or not learning occurred. I will specifically look at the Brazilian bailout relative to the bailouts given to Mexico, Asia, and Russia and reveal how the administration learned from these policy choices, but applied the wrong lessons in crafting their new policies.

Russell Crandall writes that the bailout offered to Brazil by the U.S. and the IMF was based on the successful rescue package formulated in response to Mexico's peso crisis. Furthermore, he makes a key distinction in the structure of the two bailouts that led to success in Mexico and failure in Brazil.¹⁰⁵ The bailout given to Mexico was disbursed following the full devaluation of the peso and did not try to artificially prop up the overvalued exchange rate. However, in Brazil, the purpose of the bailout was to preempt the devaluation of the real by filling the Central Bank's reserves with dollars and thereby stopping the run on the currency. The individual investors simply exchanged their *reals* for dollars prior to the overvalued currency's eventual devaluation did not follow the wishes of the policymakers. Even though these newly filled reserves were depleted, the Brazilian government was still responsible for repaying the loan. This bailout simply worsened the economic condition in Brazil. By issuing Brazil a bailout, the Clinton administration demonstrated that the lesson they learned from Mexico's bailout was that the policy generally works. Unfortunately, this was the wrong lesson to apply to the economic crisis in Brazil. If the administration had learned the right lesson, they would have waited for the *real* to devalue prior to issuing the bailout to Brazil.

The 1997 Asian financial crisis and subsequent bailouts offer additional data points relevant to the discussion on policy learning. The countries hit hardest by this crisis were Thailand, Indonesia, and South Korea. Briefly stated, Thailand is considered

¹⁰⁴ David E. Sanger, "Brazil Bailout: 2 Gambles for U.S.," *The New York Times*, November 14, 1998, <http://www.nytimes.com/1998/11/14/us/brazil-bailout-2-gambles-for-us.html> (accessed September 5, 2009).

¹⁰⁵ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 77–78.

to be the epicenter of from which this crisis spread to the rest of Asia. Stanley Fischer, former First Deputy Managing Director of the IMF, stated that the causes of this crisis can be attributed to the culmination of the following factors: overvalued exchange rates based on a strong peg to the dollar, increasing fiscal deficits, excessive exchange rate risk due to external borrowing, and a lack of political commitment to institute and maintain orthodox reforms.¹⁰⁶ These factors caused a rapid devaluation of the national currencies—very similar to the genesis of Mexico’s economic crisis.

All three countries suffered a loss in investor confidence and as a result faced rapidly depreciating currencies. Much like Mexico, Thailand and South Korea had essentially lost all of their usable reserves and requested a bailout in order to stabilize their markets. Indonesia, on the other hand, called for a bailout to preempt a run on its foreign reserves by artificially overvaluing its currency. Keeping disbursement timing in mind, the bailouts given to Thailand and South Korea prompted a swift recovery while the Indonesian bailout did not.¹⁰⁷ Stanley Fischer claimed, as a direct lesson from the Mexican crisis in 1994-1995, that the value of the currencies in Asia would have continued to fall without a bailout, and in order “to reverse this process, countries have to make it more attractive to hold domestic currency, and that means temporarily raising interest rates, even if this complicates the situation of weak banks and corporations.”¹⁰⁸ However, this statement does not recognize the point during an economic crisis at which bailouts can be issued to ensure the greater likelihood of policy success. Recognition of the reasons behind the policy successes in Thailand and South Korea and the failure in Indonesia would have better equipped Clinton’s bailout architects to craft a more useful and successful bailout package for Brazil.

The bailout of Russia in 1998 is most germane to the discussion on policy learning due to its similarity and timing relative to the Brazilian case. The Russian

¹⁰⁶ Stanley Fischer, “The Asian Crisis: A View from the IMF,” *International Monetary Fund*, January 22, 1998, <http://www.imf.org/external/np/speeches/1998/012298.htm> (accessed September 6, 2009).

¹⁰⁷ IMF Staff, “Recovery from the Asian Crisis and the Role of the IMF,” *International Monetary Fund*, June 2000, <http://imf.org/external/np/exr/ib/2000/062300.htm> (accessed September 4, 2009).

¹⁰⁸ Stanley Fischer, “The Asian Crisis: A View from the IMF,” *International Monetary Fund*, January 22, 1998, <http://www.imf.org/external/np/speeches/1998/012298.htm> (accessed September 6, 2009).

bailout was issued a few months prior to the Brazilian bailout. It is interesting to note that the Clinton administration went to great lengths to distinguish the differences between the bailout given to Russia and the one given to Brazil. Treasury Secretary Robert E. Rubin stated that, in comparison to Russia, this bailout was “totally distinct—‘totally’ is a strong word, but in all relevant respects, a totally different situation than the situation in Russia,” because Russia failed to adopt economic reforms.”¹⁰⁹ In Russia, the IMF prescriptions were embraced for three weeks following the bailout. Support for these measures in the Russian Parliament dissipated as soon as the currency devalued. The Russian Parliament then refused to implement the austerity measures.¹¹⁰ Even though President Cardoso made strong rhetorical commitment to orthodox fiscal reforms, his actual capacity to fully implement them was thwarted by his Congress and the strong state Governors. If policymakers had learned the right lessons, the administration would have recognized many important similarities between the two cases.

An examination based purely on the economic situations in both Russia and Brazil demonstrates strikingly similar conditions leading up to their bailouts. Both bailouts failed to forestall currency devaluation. If the administration had learned from the case of failure presented by the bailout of Russia, then the bailout in Brazil would not have been structured so similarly to protect the value of their currency and attempt to preempt its devaluation. “Indeed, the discouraging results from the Russian and Brazilian packages suggested that large financial bailouts failed to prevent crises, but nonetheless sweetened the pockets of international investors.”¹¹¹

The Clinton administration appeared to predicate their wanton use of the bailout based on the rescue package crafted for Mexico without due regard for the reasons behind its success. Learning would have occurred had they examined the details of the many bailouts given throughout Asia and in Russia leading up to the bailout of Brazil. The

¹⁰⁹ Paul Blustein, “U.S., IMF Announce Plan To Avert Brazilian Crisis; Loan Package Totals \$41.5 Billion,” *The Washington Post*, November 14, 1998: A.01.

¹¹⁰ David E. Sanger, “Brazil Bailout: 2 Gambles for U.S.,” *The New York Times*, November 14, 1998, <http://www.nytimes.com/1998/11/14/us/brazil-bailout-2-gambles-for-us.html> (accessed September 6, 2009).

¹¹¹ Russell C. Crandall, *United States and Latin America After the Cold War* (New York: Cambridge University Press, 2008), 78.

failed bailouts of Indonesia and Russia in 1998 should have signaled the administration that a near identical policy response attempting to preempt the economic crisis in Brazil would fail in similar fashion. The numerous bailouts structured by the Clinton administration provided a missed opportunity for policymakers to refine their craft and properly analyze conditions where a massive rescue package is likely to succeed and where it is likely to fail. Learning, however wrong it was, did occur in this case. Even though the Clinton administration applied the wrong lessons from past policy choices to future similar cases, this hypothesis is supported when examining the bailout given to Brazil in 1998 because lessons, however wrong, were learned.

3. Argentina

This hypothesis states that political leaders in the United States learn from the results of past policy decisions and are therefore better equipped to determine when and if a nation should receive a bailout. The concept of learning implies that political leaders are able to analyze the outcomes of past policy and use those results to make corrections to future policy decisions when presented with similar cases. Prior to Argentina's denied request for a bailout by both the IMF and the United States, the Bush administration was able to analyze the recent historical uses of this policy tool by both the Clinton administration and the IMF. The Bush administration had multiple cases of successful and unsuccessful bailout attempts to review and from which to draw key distinctions to better decide when this policy is maximally effective.

The notion of replenishing a nation's coffers with dollar reserves during an economic crisis was specifically addressed by U.S. Treasury Secretary Paul O'Neill in conversation with his Argentine counterpart Domingo Cavallo. O'Neill told him "that using the Fund's resources in a conventional way—to replenish reserves—would not help put the country on a sustainable path."¹¹² This statement is a result of O'Neill's analysis of the Clinton administration's support for the failed bailouts issued to Russia and Brazil just a few years earlier. These bailouts artificially held up the exchange rate just long

¹¹² Paul Blustein, *And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina*, Kindle Edition (New York: Public Affairs, 2006), 2418.

enough for major investors to withdraw their investments at a favorable rate before the reserves were emptied and the currencies devalued.

In Argentina, the Convertibility Law stringently pegged the peso to the dollar and did not allow the Central Bank to alter the exchange rate based on market forces. A review of Argentina's reluctance to alter monetary policy reveals clear parallels to the failed bailout issued to Brazil in 1998. Prior to devaluation of the *real*, a massive loan was issued to Brazil that increased investor perceptions of market instability and caused a run on the banks. This bank run drained the newly replenished reserves and forced the devaluation of the *real* and drove Brazil deep into an economic crisis. O'Neill did not favor this sort of rescue where "the IMF throws money at everybody and the private-sector people get to take their money out."¹¹³

Had Argentina devalued its currency and allowed market forces to determine the depth of the crisis, as was the case in Mexico, the debate within the Bush administration may have come out in their favor. The bailout given to Mexico was successful and due in a large part to the timing at which it was disbursed. The peso was devalued and the economy had collapsed. Therefore, an opportunity for investors to profit on a subsidized and arbitrarily overvalued exchange rate was not presented. This indicates that policy learning did occur while determining whether or not to bailout Argentina.

The Bush administration appeared to predicate their use of the bailout based on internal debate and analysis of previous bailouts. Learning from outcomes of the bailouts and conditions present within Brazil and Mexico at the times of their economic crises allowed the Bush administration to be more selective in its use of the bailout as a policy tool. The numerous bailouts structured by the Clinton administration provided an opportunity for the Bush administration to refine their craft and properly analyze conditions where a massive rescue package is likely to succeed and where it is likely to fail. Therefore, this hypothesis is supported by this case.

¹¹³ Paul Blustein, *And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina*, Kindle Edition (New York: Public Affairs, 2006), 2428.

4. Hypothesis Validity

Policymakers determine policy based on the lessons they have learned from past policy decisions regardless of whether or not the “right lessons” are learned and applied. This hypothesis states that political leaders in the United States learn from the results of past policy decisions and apply those lessons when determining whether or not a bailout will be issued to a nation experiencing an economic crisis. An examination of Mexico, Brazil, and Argentina during economic crisis and through two different presidential administrations revealed that policy learning occurred in all three cases. Therefore, the Learning hypothesis is valid according to analysis by the comparative method.

THIS PAGE INTENTIONALLY LEFT BLANK

IV. CONCLUSION

The distillation of the results of the three cases—Mexico, Brazil, and Argentina—tested against the three major hypotheses is represented in the following table:

	Geopolitical Significance	Ideology	Learning	Bailout?
Mexico	Yes	Yes	Yes	Yes
Brazil	Yes	Yes	Yes	Yes
Argentina	<i>No</i>	Yes	Yes	<i>No</i>
Hypothesis Valid?	Yes	<i>No</i>	Yes	

The above summary table demonstrates that, of the three main hypotheses, Geopolitical Significance and Learning from past policy are useful in determining whether or not a country will receive a bailout from the United States or IMF in the event of an economic crisis. To generalize these findings, I offer the following statement: All else being equal, the greater the geopolitical significance of a country in economic crisis requesting a bailout from the United States and the IMF, the more likely its request will be met. Conversely, a bailout request from a country of little geopolitical significance will likely be denied. Learning will be discussed separately.

Another generalization that can be drawn from this examination of the three cases is that adherence to orthodox market reforms alone will not secure support for a bailout request from the United States or the IMF. All three nations analyzed in this thesis demonstrated various degrees of wavering from the orthodox economic prescriptions touted by the U.S. and the IMF. Mexico and Brazil maintained their notions of sovereign governance and mitigated their deviance from the orthodox policies individually. Mexico provided its oil reserves as collateral while Brazil marketed its political stability and role as a potential South American hegemony to secure its request for a bailout. Argentina, on the other hand, offered no collateral and fell into a violent and chaotic political mess. If the situation in Argentina appeared more stable and secure to outside observers in the United States, and had the Argentine government offered some sort of significant

collateral to support their request for a bailout, it may have mitigated its relatively low geopolitical significance and received the rescue package it was looking for.

The analysis of the cases selected suggests other intricacies exist to effect the generalized statement above, and make it more or less likely that the United States and the IMF will approve a bailout request. For instance, policy learning can occur across time and presidential administration. This is dependent upon diligent advisors capable of learning the *right* lessons from a situation and the wise application of those same lessons to similar cases in the future. These advisors must have the ability to overcome the ideological bent of the administration by providing facts that necessitate and prove the likelihood of success of one policy choice over another in a given situation. This is not easy to accomplish, as these cases show both instances where policy choice trumped ideology as well as instances where ideology trumped policy choice.

With respect to the Clinton administration, the right lessons from Mexico's bailout were not learned and properly applied to Brazil's bailout. However, the administration did learn lessons from the Mexican bailout and use them to frame their future bailout policy decisions. The successful bailout of Mexico in 1995 reinforced the administration's view of the bailout as an effective policy choice without learning from when it was issued during the cycle of their crisis. Examination of its success shows that when it is issued after a currency is fully devalued by market forces, a bailout is more likely to work as advertised and stimulate the nation's economy. The lesson that the Clinton administration learned and applied to Brazil's economic crisis three years later was not specifically linked to the timing of the bailout, but rather more generally to the notion that bailouts just work. If they had waited to issue the bailout to Brazil following the devaluation of the *real*, it would have had a better chance of success. This case provides a clear example where the wrong lesson was learned and subsequently reinforced the administration's prevalent ideology in support of bailouts and was improperly applied to a similar case with negative results. In this case learning occurred but it was infected by ideology.

The bailout augmentation request that the IMF and the Bush administration denied to Argentina in late 2001 demonstrates an example of a case where effective

learning from past policy occurred. By 2001, there were many instances of bailouts that could be examined and their lessons applied to similar cases. The vigorous internal debate that divided the Bush administration's senior advisors over whether or not to issue Argentina another bailout demonstrates a case where the right lessons were learned. Treasury Secretary O'Neill recognized that conventional bailouts issued prior to a currency's devaluation where "the IMF throws money at everybody and the private-sector people get to take their money out," are not effective.¹¹⁴ President Bush's choice to support the IMF's analysis and decision regardless of the outcome with respect to the Argentine request indicates that the debate internal to his administration supplanted his general ideological opposition to bailouts. This is a case where policy learning trumped ideology.

Leaders in a position to issue massive loans must recognize the merit of each request for a bailout on its own without regard for ideology. In doing this, a more qualified determination of the potential success or failure of the policy can be made. Geopolitical significance alone should not determine whether or not a country receives a bailout. If the United States or the IMF only issues bailouts to geopolitically significant nations, then proper economic and policy analysis are not involved in the calculus. This will lead to a higher rate of loan default and overall policy failure. Lessons drawn from each bailout, successful or not, and applied without regard to ideology or politics, will ensure a better rate of success for future bailouts.

¹¹⁴ Paul Blustein, *And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina*, Kindle Edition (New York: Public Affairs, 2006), 2428.

THIS PAGE INTENTIONALLY LEFT BLANK

BIBLIOGRAPHY

- Allen, Mark, et al. *The Crisis That Was Not Prevented: Lessons for Argentina, the IMF, and Globalisation*. Edited by Jan Joost Teunissen and Age Akkerman. The Hague: Forum on Debt and Development, 2003.
- Blustein, Paul. *And the Money Kept Rolling In (and Out): Wall Street, the IMF, and the Bankrupting of Argentina*. Kindle Edition. New York: Public Affairs, 2006.
- . “U.S., IMF Announce Plan To Avert Brazilian Crisis; Loan Package Totals \$41.5 Billion.” *The Washington Post*, November 14, 1998: A.01.
- Bulmer-Thomas, Victor. “The Brazilian Devaluation: National Responses and International Consequences.” *International Affairs (Royal Institute of International Affairs 1944-)* (Blackwell Publishing on behalf of the Royal Institute of International Affairs) 75, no. 4 (October 1999): 729-741.
- Bureau of Western Hemisphere Affairs. “Background Note: Brazil.” *U.S. Department of State*. July 2009. <http://www.state.gov/r/pa/ei/bgn/35640.htm - econ> (accessed October 5, 2009).
- Campodonico, Humberto, and Manuel Chiriboga. “Third World Network.” *The Financial Crisis of Latin America and the New International Financial Architecture*. September 6, 2000. <http://www.twinside.org.sg/title/twr122f.htm> (accessed October, 31 2009).
- Clinton, Bill. *My Life: The Presidential Years, Volume 2*. New York, New York: Random House, 2005.
- Corrales, Javier. “Market Reforms.” In *Constructing Democratic Governance in Latin America*, by Jorge I. Domínguez and Shifter Michael, 74-99. Baltimore: The Johns Hopkins University Press, 2003.
- Crandall, Russell C. *United States and Latin America After the Cold War*. New York: Cambridge University Press, 2008.
- De Long, Bradford, Christopher De Long, and Sherman Robinson. “The Case for Mexico's Rescue: The Peso Package Looks Even Better Now .” *Foreign Affairs* (Council on Foreign Relations) 75, no. 3 (May–June 1996): 8–14.
- Feldstein, Martin. “Argentina's Fall: Lessons from the Latest Financial Crisis .” *Foreign Affairs* (Council on Foreign Relations) 81, no. 2 (March–April 2002): 8–14.

- “Final Vote Results For Roll Call 575.” *Office of the Clerk, U.S. House of Representatives*. November 17, 1993.
<http://clerk.house.gov/evs/1993/roll575.xml> (accessed August 28, 2009).
- Fischer, Stanley. “The Asian Crisis: A View from the IMF.” *International Monetary Fund*. January 22, 1998.
<http://www.imf.org/external/np/speeches/1998/012298.htm> (accessed September 6, 2009).
- Flynn, Peter. “Brazil: The Politics of Crisis.” *Third World Quarterly* (Taylor & Francis, Ltd.) 20, no. 2 (April 1999): 287–317.
- Gould, David, and Michelle Thomas. “Beyond the Border: A Look at the Top U.S. Trading Partners.” *The Southwest Economy* (Federal Reserve Bank of Dallas), no. 6 (November/December 1995): 10.
- Graham, Carol, and Paul Masson. “Between Politics and Economics: The IMF and Argentina.” *Current History* (Research Library) 102, no. 661 (February 2003): 72–76.
- IMF Staff. “Recovery from the Asian Crisis and the Role of the IMF.” *International Monetary Fund*. June 2000. <http://imf.org/external/np/exr/ib/2000/062300.htm> (accessed September 4, 2009).
- Johnson, Bryan T. “U.S. Foreign Aid and United Nations Voting Records.” *The Heritage Foundation*. June 12, 1998.
<http://www.heritage.org/research/tradeandeconomicfreedom/bg1186.cfm> (accessed August 30, 2009).
- Kessler, Timothy P. “Political Capital: Mexican Financial Policy under Salinas .” *World Politics* (The Johns Hopkins University Press) 51, no. 1 (October 1998): 36–66.
- Klonsky, Joanna, and Stephanie Hanson. “Mercosur: South America’s Fractious Trade Bloc.” *Council on Foreign Relations*. August 20, 2009.
<http://www.cfr.org/publication/12762/> (accessed September 4, 2009).
- Levitsky, Steven. “Argentina: From Crisis to Consolidation (and Back).” In *Constructing Democratic Governance in Latin America*, edited by Jorge I. Domínguez and Michael Shifter, 244–268. Baltimore: The Johns Hopkins University Press, 2003.
- May, Peter J. “Policy Learning and Failure.” *Journal of Public Policy* (Cambridge University Press) 12, no. 4 (October–December 1992): 331–354.

- Morris, Stephen D., and John Passe-Smith. "What a Difference a Crisis Makes: NAFTA, Mexico, and the United States." *Latin American Perspectives* (Sage Publications, Inc.) 28, no. 3, Mexico in the 1990s: Economic Crisis, Social Polarization, and Class Struggle, Part 1 (May 2001): 124–149.
- Nataraj, Geethanjali, and Pravakar Sahoo. "Argentina's Crisis: Causes and Consequences." *Economic and Political Weekly* (Economic and Political Weekly) 38, no. 17 (April 26–May 2 2003): 1641–1644.
- Office of Trade and Industry Information (OTII), Manufacturing and Services, International Trade Administration, U.S. Department of Commerce. Source: Foreign Trade Division, U.S. Census Bureau, <http://tse.export.gov> (accessed August 30, 2009).
- Onis, Juan de. "Brazil's New Capitalism." *Foreign Affairs*, May—June 2000: 107–119.
- Pastor, Manuel, and Carol Wise. "Argentina: From Poster Child to Basket Case." *Foreign Affairs* 80, no. 6 (2001): 60–72.
- Romero, Fernando. *Hyperborder: The Contemporary U.S. - Mexico Border and its Future*. New York, NY: Princeton Architectural Press, 2008.
- Sachs, Jeffrey, Aaron Tornell, Andres Velasco, Francesco Giavazzi, and Istvan Szekely. "The Collapse of the Mexican Peso: What Have We Learned?" *Economic Policy* (Blackwell Publishing) 11, no. 22 (April 1996): 13–63.
- Sachs, Jeffrey, and Zini Jr Alvaro A. "Brazilian inflation and the Plano Real." *World Economy* (Blackwell Publishers Ltd) 19, no. 1 (January 1996): 13–37.
- Samuels, David. "Fiscal Straitjacket: The Politics of Macroeconomic Reform in Brazil, 1995-2002 ." *Journal of Latin American Studies* (Cambridge University Press) 35, no. 3 (August 2003): 545–569.
- Sanger, David E. "Brazil Bailout: 2 Gambles for U.S." *New York Times*, November 14, 1998, Late Edition (East Coast) ed.: A.4.
- Springer, Gary L., and Jorge L. Molina. "The Mexican Financial Crisis: Genesis, Impact, and Implications." *Journal of Interamerican Studies and World Affairs* 37, no. 2 (Summer 1995): 57–81.
- Stevenson, Richard W. "U.S., in Shift, Says It Backs Latin Bailouts." *New York Times*, August 2, 2002, Late Edition (East Coast) ed.: C.1.

Thacker, Strom C. "The High Politics of IMF Lending." *World Politics* (The John's Hopkins University Press) 52, no. 1 (October 1999): 38–75.

Theberge, Alexander. "The Latin American Debt Crisis of the 1980s and its Historical Precursors." *Working Paper*. April 8, 1999.
<http://www.columbia.edu/~ad245/theberge.pdf> (accessed August 29, 2009).

Tornell, Aaron, Frank Westermann, and Lorenza Martínez. "Liberalization, Growth, and Financial Crises: Lessons from Mexico and the Developing World." *Brookings Papers on Economic Activity* (The Brookings Institution) 2003, no. 2 (2003): 1–88.

Uchitelle, Louis. "Calculated Risk: U.S. and I.M.F. Lead Push for Brazil Bailout Plan." *New York Times*, September 28, 1998, Late Edition (East Coast) ed.: A.1.

INITIAL DISTRIBUTION LIST

1. Defense Technical Information Center
Ft. Belvoir, Virginia
2. Dudley Knox Library
Naval Postgraduate School
Monterey, California